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SOCIAL SECURITY "NOTCH" ISSUE

HEARING

BEFORE THE

SUBCOMMITTEE ON
SOCIAL SECURITY AND FAMILY POLICY

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

JANUARY 23, 1989

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SOCIAL SECURITY "NOTCH" ISSUE

MONDAY, JANUARY 23, 1989

U.S. SENATE,
SUBCOMMITTEE ON SOCIAL SECURITY AND FAMILY POLICY,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10 a.m., in Room SD-215, Dirksen Senate Office Building, Hon. Daniel Patrick Moynihan (Chairman) presiding.

Present: Senators Riegle and Chafee.

[The prepared statement of Senator Robert Dole appears in the appendix.]

[The press release announcing the hearing follows:]

[Press Release No. H-3, January 11, 1989]

FINANCE SUBCOMMITTEE TO HOLD HEARING ON SOCIAL SECURITY "NOTCH" ISSUE

WASHINGTON, DC—Senator Daniel Patrick Moynihan, (D., New York), Chairman of the Senate Finance Subcommittee on Social Security and Family Policy, announced today that the Subcommittee will hold a hearing on the Social Security "Notch" issue.

The hearing is scheduled for *Monday, January 23, 1989 at 10 a.m.* in Room SD-215 of the Dirksen Office Building.

In announcing the hearings, Moynihan said, "We look forward to reviewing the findings and recommendations of the National Academy of Social Insurance on this extremely complex and important issue. We will also be hearing from a number of organizations that represent our Nation's senior citizens. Social Security is our most important domestic program, a true government success story, and it is vital that we maintain a system in which the public can have full confidence."

Senator Moynihan and Senator Robert Dole, ranking Republican on the Subcommittee, asked the National Academy of Social Insurance to do a study on the Notch issue last year, and the report was released in November. The "Notch" refers to a disparity in benefit levels between Social Security retirement beneficiaries born before 1917 and those born later.

OPENING STATEMENT OF HON. DANIEL PATRICK MOYNIHAN, A U.S. SENATOR FROM NEW YORK, CHAIRMAN OF THE SUBCOMMITTEE

Senator MOYNIHAN. I want to welcome everybody to today's hearing of the subcommittee concerning the Social Security benefit Notch, as it has come to be called.

This is a matter that has attracted considerable attention in recent years, and is deserving of the most careful, compassionate and nonpartisan enquiry.

With this in mind, on March 7 of last year Senator Bob Dole, who is the distinguished Ranking Minority Member of our subcommittee (and who is, of course, the Republican Leader of the Senate) and I wrote to the newly established National Academy of Social

Insurance to ask if they might conduct such an enquiry for us. The Academy promptly agreed, and the following November 14 Alicia H. Munnell, who is President of the Academy, sent us their report. Senator Dole and I, with the cordial cooperation of Senator Bentsen, the chairman of the full committee, arranged a hearing to be held on the first day of normal business of the 101st Congress, in order that we might hear from the Academy, and from other interested parties.

We are much indebted to the Academy, and most especially to its learned study panel, headed by Mr. Robert J. Myers. All students of Social Security are students of his; and all Americans are indebted to him.

This is the first occasion on which the committee has had to call upon the Academy; thus beginning what will surely prove a long and fruitful relationship.

If I may put it this way, there is, or ought to be, a rule of sorts in these matters, which is that everyone is entitled to his own opinion, but not to his own facts.

We asked the Academy for the facts and now we have them.

By a happy circumstance, unbeknownst to us at the time, just as the Senate was commissioning a study of the Notch, the House was receiving one. Our distinguished friend and colleague the Honorable Andy Jacobs, Jr., Chairman of the Subcommittee on Social Security of the House Committee on Ways and Means, received a report from the Comptroller General. The GAO report was submitted on March 24, not 3 weeks after our request was made.

We take it to be of considerable importance that the two reports, somewhat different in their modes of analysis, are identical in their conclusions. It will be our special pleasure this morning to have with us Mr. Joseph Delfico, the learned and thoughtful author of the GAO report, who will relate to their conclusions.

I could scarcely not be aware that the conclusion of the two reports will disappoint some. This is understandable. A situation has arisen which seems unfair. It is not. No retired person is receiving less in Social Security benefits than Congress intended. Some are receiving more. Well, that happened. Nobody planned it; certainly not the beneficiaries.

There is a large consideration here which we should perhaps bear more in mind than we seem to do.

For the present generation of retired American workers, Social Security is truly a generous system. It is not easy to compute the proportion of Social Security benefits which can be attributed to Social Security contributions. That is to say, what would the accumulated old-age and survivors insurance tax payments by a statistically average worker and his employer actually "buy" in the way of survivors insurance and retirement benefits? However, the estimates I have heard suggest that current retirees have paid in less than 15 percent of what they will get back as benefits.

Now this is to say that 85 percent or more of Social Security benefits for current retirees is, in effect, a transfer payment. There is nothing unusual about this. To the best of my knowledge most social insurance systems—around the world that is—provide this "windfall" for early members. And not too long into the next century things will have to even out for government sponsored insur-

ance and annuities, just as they must do now in the private sector. But the present situation is worth keeping in mind.

Finally, may I note that Senator Dole regrets that a long engagement keeps him out of the city today. I will have a statement by him which will be placed in the record and which will be available to the press before the morning is out.

I want to note that Ms. Dorcas Hardy, the head of the Social Security Administration, for quite understandable reasons, felt that she could not appear at this point, it being the case that there's a new administration taking office and the officials are not yet in place to look at this. We will have a statement from the Social Security Administration before this record is closed. I will ask that it remain open until we do.

[The prepared statement of the Hon. Dorcas Hardy appears in the appendix.]

I am very pleased to see my good friend Mr. Chafee here this morning.

Sir, would you like to make some remarks?

OPENING STATEMENT OF HON. JOHN H. CHAFEE, A U.S. SENATOR FROM RHODE ISLAND

Senator CHAFEE. Yes, I would.

I would like to thank you all very much for holding this hearing on the Notch issue. This is an issue that, of course, all of us have been very, very concerned about and particularly those of us who recently went through an election campaign where the matter was constantly brought to our attention. So it is an understatement to say that it has created a good deal of controversy over the past few years and I am delighted we are going to have an opportunity to discuss it today.

Congress, as we recall, made changes in the Social Security system in 1977 to help ensure, the long-term stability of the fund. Those changes were necessary. I voted for those changes. I suspect you did too, Mr. Chairman.

Senator MOYNIHAN. I did.

Senator CHAFEE. But what resulted was a transition formula that was not smooth. And again, that is an understatement. I do not believe our intention was to adversely affect Social Security recipients between the years of 1917 and 1921, the so-called Notch years.

It is clear to me that the transition formula inadvertently provided individuals with a difference in benefit levels—here is the problem. We have individuals working exactly the same length of time, the same work histories, the same contributions, receiving desperate benefits. That is where the rub comes, as you so well know.

So I am eager to discuss the enactment of a smoother transition formula for those affected by the Notch if it can be done without jeopardizing the solvency of the trust fund. That must be our number one responsibility in this committee and in the Congress, to make certain that we in no way threaten current beneficiaries.

It is my hope, that we can responsibly resolve this issue. In the last Congress I joined Senator Sanford in sponsoring a Notch adjustment act, the legislation was then S. 1830. This proposal would

gradually increase the Social Security benefits received by people born between 1917 and 1929. I thought that measure fairly addressed the concerns of those affected by the Notch without endangering the reserves in the fund. That is what we are going to hear about today.

I do not know, Mr. Chairman, whether we are going to specifically address certain legislation. Perhaps they will. Hopefully, they will. But I am glad we are going to have an opportunity to hear these witnesses.

You talked about Bob Myers. I always connect Bob—How old is Bob Myers?

Senator MOYNIHAN. He's ageless. Ageless and enduring.

Senator CHAFEE. Was he at Franklin Roosevelt's elbow in 1936 when this——

Senator MOYNIHAN. He is the man who whispered into Wilbur Cohen's ear.

Senator CHAFEE. He was.

Senator MOYNIHAN. It is a well-known fact.

Senator CHAFEE. Well, he has been—ever since I have been here and you and I have both been here—he has been kind of a squeeze on this matter. And his credentials are—he was the staff director of the commission you served on, the Greenspan Commission.

Senator MOYNIHAN. That is right, sir. Previously, he was the chief actuary of the Social Security Administration.

Senator CHAFEE. He is one of these people, like General Hershey, that is always around and we are glad he is. So we look forward to hearing Mr. Myers testimony as part of the National Academy of Social Insurance.

But I hope, Mr. Chairman—certainly I am not backing away from concern on this matter that I voiced during the recent campaign, that somehow something can be done, because it is easy to tell folks, oh, you are getting everything that you are entitled to. But when their brother-in-law is getting a lot more who has worked exactly the same period, made the exactly the same contributions, and the only difference being that he was born a year earlier, you can understand the sense of indignation.

Hopefully, we can work toward a resolution of that. So I look forward to the testimony.

Thank you, Mr. Chairman.

Senator MOYNIHAN. Thank you, Senator.

Well, as our witness list indicates, we begin with Mr. Robert J. Myers, the timeless authority in these matters, who is the chair of the Notch Study Panel that was provided us by the courtesy of the National Academy. Mr. Gary Burtless, Ms. Suzanne Dilk and Mr. James W. Kelley were your associates.

Good morning, sir. We look forward to your testimony.

Senator CHAFEE. I wonder, Mr. Chairman, before Mr. Myers starts if in a succinct manner, he might outline the Notch problem. I am not saying to go way back in the history.

Am I correct, and I am confident I am, but if I am wrong I want to be corrected, that we made some mistakes in the calculations. I believe it was 1973, wasn't it, 1972?

STATEMENT OF ROBERT J. MYERS, CHAIR, NOTCH STUDY PANEL, NATIONAL ACADEMY OF SOCIAL INSURANCE, SILVER SPRING, MD

Mr. MYERS. 1972.

Senator CHAFEE. Therefore, the payments were at a higher scale than had been anticipated. So then in 1977, the conclusion was, we had a series of options. We could have ended those payments or we could have revoked them. That would have been unfortunate. Or we could have halted them arbitrarily and dropped down to where the level should be. Or we could come down in a series of steps to get to where the actuarily sound payments and those prescribed in law would be.

Am I correct in that?

Mr. MYERS. Yes, Senator Chafee, you are essentially correct in what you say.

The problem really arose through two pieces of legislation. The 1972 legislation as you say, was faulty in the way that the benefits were calculated, and under the economic conditions that prevailed, the benefits would have been ever increasing, so that the benefit cost would have gone out of control.

Then in 1977, when this was corrected for the future—that is for people reaching age 62 in 1979 and after—the transition procedures were not developed as well as they might have been, to put it kindly. What happened was that the people who reached 62 before 1979 and who continued working, as I will bring out in a little more detail in my testimony, received benefits that were ever larger and much too large. In fact, what they got was windfalls.

So that it made an unfortunate gap and the people born in 1917 and later—although I think they are getting the proper benefits, as the chairman said—are getting less than some people who were born just before them.

Of course, people tend to look at it that way, as, not am I getting the right amount, but is somebody else getting more than I am.

Senator CHAFEE. So then in 1977 we brought them down in steps. Is that not correct?

Mr. MYERS. In part, yes.

We brought them down in steps, particularly for those who retired at age 62. But there was not really proper procedure done with regard to people who worked well beyond age 62. Some of my charts will indicate this.

Senator CHAFEE. All right. I am sorry. If you are going to cover this in your testimony, I do not want to belabor it here. Why don't you go ahead, Mr. Myers.

Senator MOYNIHAN. Could I just add one thing. When we say mistake, is it not really the case that in the 1970s for the first time in the history of the system prices ran ahead of wages and that had never occurred, and when that did occur the formulas which otherwise would have worked just did not?

Mr. MYERS. Yes, that is correct. What was done in 1972 would have worked out just fine if economic conditions thereafter had been as they were in the 1950s and 1960s.

Senator MOYNIHAN. Yes.

Mr. MYERS. But as you well know, economic conditions since then have been very, very much different, and it just did not work out properly.

Senator MOYNIHAN. John, you follow that, don't you?

Senator CHAFEE. You mean the inflation ran and so forth.

Mr. MYERS. Yes.

Senator MOYNIHAN. Ran ahead of wages. That had never happened before in the history of the system.

Well, sir, go ahead.

Mr. MYERS. Just to answer one other question that Senator Chafee asked—about how old I was. When I subtract my year of birth from 1989, surprisingly, I get a figure of 77. Now, I am pretty good at math so I know that figure is right. But it just does not seem that way to me. [Laughter]

Senator CHAFEE. Well, just to show you are not omnipotent, Mr. Myers, it is Chafee, not Chaffee.

Mr. MYERS. Oh, I am sorry.

Senator CHAFEE. Otherwise, your record is perfect.

Mr. MYERS. Thank you.

First of all, I want to thank both the chairman and Senator Chafee for their very kind remarks about the National Academy of Social Insurance and about me.

The National Academy is a nonprofit, nonpartisan organization devoted to furthering knowledge and understanding of Social Security and related programs. The National Academy takes responsibility for assuring the independence of any panel formed under its auspices.

Panel members are selected for their recognized expertise and with due consideration for the balance of disciplines appropriate to the project. The resulting report is the responsibility of the panel members, but in accordance with the procedures of the Academy, it has been reviewed by a committee of its Board for completeness, accuracy, clarity and objectivity.

I would like to illustrate the analysis and findings of our study panel by discussing several charts and tables.

Chart 1 shows the current monthly Social Security benefits for people born in various years who had average earnings histories and who retired at age 65. If you look at just the right-hand portion of the chart, that is for people born in about 1912 and later, it would appear that there is a very serious Notch or dip, for people born after 1917 and before about 1922.

However, if you look at the entire chart, you will see that except for a peak for people born in 1912 to 1916, there is a gradual upward trend. In other words, the benefits for people born many, many years ago in current dollars are lower than for people retiring after 1917 and even out into the future.

This is part of the general character of the system that I am afraid many people do not realize. The system is intended to provide constant replacement rates as of the time of retirement. That is, the benefit will represent for an average wage worker about 41 or 42 percent of his or her earnings if retirement is at 65.

Senator MOYNIHAN. That is for an individual or for a couple?

Mr. MYERS. For an individual.

For a couple, if the spouse is not working, there is a 50 percent larger benefit. Of course, if the spouse has a benefit in his or her own right, the two are paid separately.

Senator MOYNIHAN. Right.

Mr. MYERS. As a result of prices generally increasing less than wages, the dollar amounts will tend to be higher for later retirements than for earlier ones. And again, if you look at that chart, you can see that upward trend starting with people born in 1895 up to people born in 1935, with that peak in the years of 1910 to 1916.

That peak is the mistake, really, that was made in the 1972 amendments when it was not realized that economic conditions would not always be the way that they were in the 1950s and 1960s. That peak really represents a windfall or bonanza to those people who worked on beyond age 62.

Later on, I will point out that, if all people retired at age 62, there was no Notch at all like this.

Now, if you look at this chart, one might argue that the people who were born many, many years ago—in the 1890s and early 1900s—are getting too little because they are getting less than even the so-called "Notch" group. But, as I say, this is a basic characteristic of the system.

As I indicated, the proper way to consider whether equitable benefits are being paid is to examine replacement rates, as is done in Chart 2.

Senator CHAFEE. Excuse me. Could I interrupt you just long enough to find out whether the charts you are discussing are the same charts as in your documents here?

Mr. MYERS. They are attached to my testimony. Yes, sir.

Senator CHAFEE. I see.

Mr. MYERS. Chart 2 gives replacement rates, again for workers who had average earnings during their careers and who retired at age 65 in various years. Here the peak is even more evident than it was in the dollar figures. Workers who were born in 1916 who retired in 1981 have a replacement rate well in excess of 50 percent, whereas the goal and long-range results will be replacement rates of about 41 or 42 percent.

There was a transition, as you know, a so-called "transitional guarantee" and that did help raise the benefits of people born after 1916. So that, instead of the peak dropping off sharply to 41 percent, it goes down gradually. Actually, those born in the so-called "Notch" years of 1917 to 1921 are treated better than people who come later.

You will also note on the left-hand side of the chart that the replacement rates for people who were born before 1910 are at a much lower level. Such rates were only about 31 or 32 percent. They gradually increased for persons born later. If things would have worked out properly, they would have increased only to the 41 or 42 percent level that will be assured in future years.

Chart 3 examines the matter from another angle, by considering replacement rates for men who retired in various years and who had average earnings, with two options as to the retirement age—one at 62 and one at 65.

I should point out that this chart is for men. For people who became 62 before 1975, the benefits for women were slightly larger

than for men, although now there is completely equal treatment. That is why I used men in that chart.

As you will see, the figures in the right-hand column are the same as in the previous chart. They rise to a peak of 51 percent for people born in 1916 who retired at age 65 in 1981. Then, they fall off gradually for people born after 1916, to the ultimate level of about 41 percent.

However, when you look at the retirements at age 62, the very important fact comes out that there is no Notch. There is no variation once you look at people who attained 62 in 1975 and after. The replacement rate for those people in all years, whether it is in the Notch years, or pre-Notch years, or post-Notch years, is about 33 percent. The rate is, of course, much lower than for those who retire at age 65, because, when people retire at 62, as you know, there is a 20 percent reduction in benefits.

Senator MOYNIHAN. Could I just interrupt to say for the record, or to ask to see if I am not correct in saying that—and it is a rather interesting point—the majority of retirements now take place before age 65. Is that not the case?

Mr. MYERS. That is correct. Slightly more than half do retire at age 65. As you can see from these figures, and from some figures I will present in a moment, there really was no problem at age 62. I am not in favor of people retiring early. But if they had all retired at 62, we would not be meeting here today.

Chart 4 brings out this point in another manner. It shows the benefits for both average wage earners and maximum wage earners who are right at the breaking point. Somebody who reached 62 just before 1979—that is born in 1916—and somebody in the Notch group who was born at the very beginning of it—early in 1917.

If both of these individuals, with identical earnings records, had retired at the same point—in January 1979—their benefits would have been virtually identical, a difference of only $6 a month. But if these individuals, instead of retiring at age 62, had gone on working and retired at later times, the difference—or the Notch—becomes larger, until eventually it is almost $150 for the average wage earner and as much as almost $200 for the maximum wage earner.

This, of course, is a very unfortunate situation. But as our analysis and conclusions bring out, it is not that the people in the Notch years are getting too little, it is that the other people are getting a windfall or bonanza and are getting too much.

It is sometimes said that those born in 1917 to 1921 are treated inequitably as compared with those born later. This just is not the case. There is, of course, no question that a Notch exists between the pre-1917 births and the post-1916 births when they go on working well beyond age 62. But when you look at the 1917 to 1921 group as against those born in 1922 and later, there is no inequitable treatment. This is shown in Chart 5.

Here, I took again the boundary point, people born in late 1921 against people born in early 1922 who had the same earnings record and retired on the same date. Regardless of whether these people retired at age 62, or 63, or 64, or 65, the benefits are virtually identical. Differences, as you see, of only $3 or $4 a month, whether it is an average earner or a maximum earner. So, there is

complete equity between the Notch group and those who come later.

The last chart, Chart 6, shows illustrative monthly benefits for people born in late 1916 if the proper transitional procedure had been adopted in the 1977 legislation. It shows their actual benefits as compared with what they would have been if the correct procedure had been adopted. It also shows what the benefits are for people born in 1917.

The difficulty with the transition procedure that was adopted in 1977 is that people who reached age 62 before 1979 continued to have their benefits computed under the old, flawed method of the 1972 Act.

What should have been done—and I must say in all modesty, I suggested this in testimony, but unfortunately it was not followed—was that their benefits based on earnings after 1978 should have been computed under the new Average Indexed Monthly Earnings method that is applicable to people currently retiring and applicable to those born in 1917 and later.

If that had been done, the results shown in this chart would have prevailed. That is, under the "born in 1916" column, the figures outside of the parentheses are what would have resulted as against the figures in parentheses which have actually occurred.

If that correct procedure had been adopted, the Notch, such as it was, would have been relatively small. You can see the difference between the two columns. The difference in the benefits columns is only a few dollars a month, up to as much as $20 a month for the average worker and $40 a month for the maximum worker. In fact, if they go on working long enough after age 62, the difference swings around the other way.

The reason for that swing in the difference is that the so-called deferred retirement credit that people get for working beyond age 65 is only 1 percent for the early group—that is those born before 1917—and it is 3 percent for the people born in 1917 and later. That, at least, if I may again say immodestly, is one thing that I did get in the law in 1977 to ameliorate the differential a little bit. But it does not really solve the Notch problem.

In summary then, Mr. Chairman, the real problem with regard to this matter is that those persons who were born before 1917 who worked well beyond age 62 after 1978 receive undue windfalls or bonanzas. Those born after 1916 are equitably treated, consistent with the intent of Congress, and they receive proper benefit amounts —which, incidentally, are far more than the amounts "actuarially purchased," which as, I think the Chairman said, is only about 15 percent of their benefit.

There is no reason why young workers should, over the years, pay more taxes to provide windfall benefits to this group—persons born in 1917-21. Conversely, although there is a case for reducing—gradually or otherwise— the windfall benefits for some persons born before 1917, this would not now be equitable. The panel therefore recommends that Congress take no legislative action on this Notch benefit issue.

Mr. Chairman, I would like to make one further remark about——

Senator MOYNIHAN. Please do, sir.

Mr. MYERS. I would like to point out a Notch situation that is, unfortunately, just beginning as a result of the Medicare Catastrophic Coverage Act of 1988.

This Notch is as follows: People who attain age 65 in June of this year will pay as much as $800 more in supplemental premiums than a similar person born just a few days later. This same situation will occur year after year into the future. It will also occur for deaths in July as against deaths in June.

This matter can be nipped in the bud if Congress takes action, and it is a very simple action. The supplemental premiums really should be on a pro rata basis, depending on the number of months of eligibility during the year, rather than on an all or none basis, the way it is in present law, where people who are eligible for 7 months in a year pay the full premium while people eligible for 6 months or less pay no premium.

Senator MOYNIHAN. I see. Mr. Myers, I think the Academy just got itself a request for another report. We thank you for flagging that.

We will just for the moment say on this issue—Senator Riegle, we welcome you to our hearing this morning.

Senator RIEGLE. Thank you, Mr. Chairman.

Senator MOYNIHAN. Would you like to make some opening remarks or comment?

OPENING STATEMENT OF HON. DONALD W. RIEGLE, JR., A U. S. SENATOR FROM MICHIGAN

Senator RIEGLE. Mr. Chairman, only one or two thoughts and I appreciate the courtesy of the Chairman.

The Notch Issue I must say is one that has aroused great interest and concern throughout the country. I certainly have seen that in the State of Michigan. I cannot recall the last time that I attended any substantial public gathering where I have not had the Notch Issue arise more than one time. I am sure my colleagues have found the same thing.

I think you make a very strong and well documented presentation today. The problem is that it does not necessarily lead us to an answer, a very agreeable answer. I am still looking at the chart which you have which graphicly displays the Notch and I want to continue to explore ways in which we might somehow find a way, perhaps in a fashion we have not yet thought of, to make some adjustment here between this sharp inequity that is on either side of an age line.

It makes no sense. The fact that we say, well, that was a mistake we made a long time ago and we created a windfall and there is really nothing we can do about it. That may be the best of a bad set of answers. I am not prepared to assume that it is. But I think it is sort of a lame answer. I would like to think we could find some way to deal with the sharp peaking of that curve on your chart that is titled "Social Security Replacement Rates for Age 65 Retirees With Average Earnings."

There may well be some way to do that. You might even do it with adjustments to COLAs, say, on either side of the line over a period of time in the future. There might be a way to take and sort

of round off that sort of mountain peak and try to establish more equity back and forth between the groups that are literally days apart, or weeks apart, on either side of that line.

Now, I agree with you. It is very difficult if you reach back in time to try to, in any major way, undo the benefits of the pre-Notch group. But there may be some way to, if we think of a band on either side of the Notch as the most effective group, to think about how we might over a period of time sort of bring that peak down and broaden it out over a broader base.

That is the thought I have for today.

Thank you, Chairman.

Mr. MYERS. Senator Riegle, I agree completely that this is a most unfortunate matter, and I can well sympathize with the people of the Notch years. I have talked at a number of meetings on this subject and explained it as I have done today. They still, of course, say that somebody, by accident of a few days' or weeks' birth, is getting a lot more than I am.

It is a most unfortunate thing. In the field of Social Security over the years, the people who have developed the benefit structure have always tried to prevent things like this. This is one case where it was not done.

Senator RIEGLE. You make a good point.

I think your suggestion on the Medicare, or the Catastrophic Medicare Notch that may have just been inadvertently created, sounds to me like something that we really need to go back and deal with before we find that that compounds itself into a difficulty like this that extends for years into the future.

But I still want to think about whether there is a way to perhaps construct a band, pre-Notch into the Notch, and figure out how over some time period into the future we might not be able to do some leveling out here to take some of the real inequity that is right on its face out of this problem.

Mr. MYERS. I think the point that you made is probably the best way of doing it—or certainly the least worst—namely, to hold down the COLAs on the people who are getting these windfalls.

Senator RIEGLE. Well, maybe just on the part of the windfall and maybe you use that to provide some benefit to the people in the Notch. In other words, there may be a way to sort of average. It is not a happy answer. But the point is that you got a degree of inequity here that is terribly sharp, given how abruptly these lines rise and fall on this graph.

Mr. MYERS. And I think, as you recognize, that it is very difficult to tell who is getting these bonanzas. As I pointed out, people who retired at 62 are not. If they retired at 62-1/2 there is a little windfall .

It is not a clear-cut thing. It is a very difficult issue. It is one that I have worried a lot about and tried to figure out some way of doing something about. Our report is the best that our panel could come up with.

Senator RIEGLE. Well, I think we should take it and run with it and see if we cannot come up with some kind of a more positive answer.

Thank you, Chairman.

Senator MOYNIHAN. We thank you, Senator. Senator, Chafee.

Senator CHAFEE. Well, Mr. Chairman, I am unenthusiastic about the suggestion that we reduce the peak of those who are—if that was the suggestion—I may have misunderstood it. I am not out for flattening off that peak. I am up for raising the valley if we can do it.

What we are waiting for here, it seems to me, is the statements regarding the solvency of the fund and what corrective ameliotory action would have on that solvency.

One of the other things I would interested in, Mr. Myers, is can we identify those who seem to have lost out in the deal. Can you identify them through some manner?

You indicated it is extremely complex due to when they retired. If you were born in 1915 and you worked to 62-1/2, I take it that that is the maximum of the bonanza. Is that correct? In that area.

Mr. MYERS. Working beyond 62, any number of years. The more you work, the more the bonanza.

Senator CHAFEE. So what I am interested in—if you look at your Chart 2—is taking those who were down there. It looks like 1920 was about the bottom of the valley. Am I correct in my analysis of it?

Mr. MYERS. Yes.

Senator CHAFEE. That is the group—and those born a little earlier—as you come down that slope from those who were born in 1916—that is the group that I am interested in seeing if we can do something about. Based always upon the fact that we want to preserve the solvency and the strength of the system.

Mr. MYERS. Senator Chafee, I think that, if you are going to do anything about any group, it would be for those born, roughly, in 1917 to 1921, the so-called Notch group, who worked beyond age 62.

But for those who retired at age 62, is there no inequity at all.

Senator MOYNIHAN. There is no Notch.

Mr. MYERS. If somehow or other you could give some recognition to them, that would be, again, the least worst way of taking any action.

Senator CHAFEE. Have you done—and I do not want to get ahead of your testimony—any calculations on the costs of that and the effect on the fund?

Mr. MYERS. No. There have been a number of proposals made, one of which you co-sponsored. There have been cost estimates for those. But they were of a much broader nature than merely dealing with people who worked beyond age 62.

Some proposals, depending on how much they increased benefits, could have aggregate costs of much as $300 billion over the years. Others would be much less than that. It just depends on how much the proposals do. There is no one right answer certainly.

Senator CHAFEE. There are no mechanical problems, are there, in identifying these people, or are there? In other words, we can go back, I presume, and identify who were the principal ones who lost out. In other words, those who worked beyond—were born in 1918 and worked beyond—worked to the age of 64, for example.

You can pick those people out, I presume, on the computer, is that right?

Mr. MYERS. I believe that it could be done. It would be a big computer run. You would go through many people to find relatively few. But it could be done I think.

Senator CHAFEE. Thank you.

Thank you, Mr. Chairman.

Senator MOYNIHAN. Thank you, Senator.

Two, three points just to be clear about again. Would it be correct to say that of the persons in the 5 years of the Notch, for 3 of those years, the replacement rate now being paid is higher than the 41.5 percent that follows?

Mr. MYERS. That is correct.

Senator MOYNIHAN. Could I ask my colleagues to focus on that. Of the 5 years, there are 3 in which the Notch persons are getting a higher rate than the people who follow them. Not always a higher amount because the wages have been gradually growing. So that is something to keep in mind.

Second, sir. I know this is an immensely difficult calculation, which only a person such as yourself and the GAO, Mr. Delfico, might be able to try. I heard you say, on average, the contributions from the FICA tax, the Federal Insurance Contributions Act, by employee and employers, on average, would pay for about 15 percent of the present benefits. Would that be your judgment?

Mr. MYERS. The figure of 15 percent that I gave was based on only considering if that is the amount that would be bought by the actual contributions of the worker, without considering the interest on them. On this basis, the most that anybody would have bought was about 15 percent. Thus, under some of the current proposals for taxing 85 percent of the benefits, nobody would be taxed on more than they had really paid in.

Now if, from an actuarial standpoint, you allow for interest——

Senator MOYNIHAN. Which you should do.

Mr. MYERS. Which you should do for determining whether people getting their money's worth, then you get a higher figure—somewhere between 20 and 25 percent of benefits.

Senator MOYNIHAN. I see. So something like 75 percent of benefits are a transfer.

Mr. MYERS. Yes.

Senator MOYNIHAN. The last point, because it seems to me to be just something we should keep in mind, it is the case, is it not, that about half of persons reaching 62 retire then and there?

Mr. MYERS. Yes, that is correct. About half claim benefits. Some low-paid people can still be working and getting benefits. But accurately stated, about half claim their benefits at age 62.

Senator MOYNIHAN. We had, as you know, in the Commission which you so ably directed, we looked to increasing the age at which full retirement benefits are available without changing the age 62 availability. We got a 67 in about 2020, do we not?

Mr. MYERS. 2027.

Senator MOYNIHAN. 2027. That is over the next 40 years. But people are retiring very early who we might think have good years left in them.

Mr. MYERS. This may well turn around in the coming years.

Senator MOYNIHAN. Well, sir, when it does, Robert J. Myers will be an example of why it should.

Mr. MYERS. Thank you.

Senator MOYNIHAN. I want to thank you.

Senator RIEGLE. Mr. Chairman, before you finish with him.

Senator MOYNIHAN. Please, sir.

Senator RIEGLE. When you finish, I would like to ask one other question.

Senator MOYNIHAN. Please. I am finished.

Senator RIEGLE. If I may, I want to just go refer to the chart here and ask him a question by pointing at the chart.

Senator MOYNIHAN. Do anything you want.

Senator RIEGLE. Let me just ask you, because I try to think about these options in the long-cost differential. It seems to me that people who are right in this area are receiving the most inequitable treatment. Because they are inequitably treated so that the relationship with the people who are back into this category, but they are also drawing less than people out here who come after them. So they, in effect, suffer a kind of inequity both ways.

So it seems to me that anybody that is in sort of this part of the curve right here really has the biggest argument to make, in terms of fairness, both backward and forward. Now if you were trying to do something to level this out, to deal with this Notch problem, there are lots of ways you might try to do them. Each one has a different cost.

You could come right straight down like this. You could come down around like this so that you augment everybody that is in the Notch to some degree, but that you would try to take out the bottom part of this trough which really, to me, seems to be the part that—at least on the face of the way one looks at this graph—would be the most inequitable position to be in.

Can you, from just off the top of your head, give us any sense as to what the cost perimeters might be if you did something that looked like that, filled in this trough here, and came up and provided some increment, but really dealt with most of the replacement falling into this zone? Any sense for what that might look like?

Mr. MYERS. Senator Riegle, I certainly agree with your logic there. It is unfortunate, in hindsight, that it was not 10 years instead of a 5-year transitional guarantee. In one of the versions of the bill as it was being considered in 1977, there was a longer transition period, but it was cut back to 5 years. Again, in hindsight, unfortunately.

As to how much it would cost to fill in the Notch in the general way that you say, I really cannot speak with any exactitude. Obviously, it would be nothing like the $300 billion, or even the $70 to $80 billion of some of the bills. It would be probably more in the order of $5 to $10 billion spread out over all future years.

It just depends on how you do it and whether people would be appreciative of the amounts involved if they got only another $5 or $10 a month. Many would not get anything. You would perhaps have more disappointed people than ones who would like the situation.

Senator MOYNIHAN. There are always those who follow who will be down at 41.5 and lower than those.

Thank you, again, sir.

Senator CHAFEE. Could I ask one other question, Mr. Chairman.

That is, in doing this, I take it that we should follow the replacement rates, the percentages. That is the key figure that we look through in this. In other words, what you have on Chart 3, whether it is 41 or 51 or 45, those we should not consider dollars, we should always think of replacement percentages.

Am I correct in that?

Mr. MYERS. Yes. You are absolutely right, Senator Chafee.

Senator CHAFEE. Thank you, Mr. Myers.

Senator MOYNIHAN. Before you depart, may I thank Miss Sarah Berman of the National Academy who has been our very able display director for this morning.

Thank you, sir.

Mr. MYERS. Thank you.

Senator MOYNIHAN. Now we have a distinction which is somewhat rare for our Committee, to hear from the General Accounting Office, Mr. Joseph Delfico, who is the Director, Income Security Issues, Human Resources Division, GAO.

As I mentioned in an opening statement, Senator Riegle, so it happens that just 3 weeks after Senator Dole and I requested a report from the National Academy, the GAO presented a report to our House counterpart, the Subcommittee on Social Security, Committee On Ways and Means, Mr. Jacobs. We thought it would be useful, since we have not heard ourself from GAO to have them here.

We are particularly pleased to have Mr. Delfico. You have some colleagues with you, sir. They are Mr. Kenneth Bombara.

Mr. Bombara, good morning.

And Ms. Laurie Ekstrand.

Ms. Ekstrand, good morning to you.

Mr. Delfico.

STATEMENT OF JOSEPH F. DELFICO, SENIOR ASSOCIATE DIRECTOR, HUMAN RESOURCES DIVISION, ACCOMPANIED BY KENNETH BOMBARA, ECONOMIST AND LAURIE EKSTRAND, GROUP DIRECTOR, HUMAN RESOURCES DIVISION, GENERAL ACCOUNTING OFFICE, WASHINGTON, DC

Mr. DELFICO. Mr. Chairman, as you have noted, Ms. Ekstrand and Mr. Bombara are here today with me and they are the primary team that worked on our report presented last year to the Ways and Means Committee and in testimony to the Ways and Means Committee.

With your permission, I would like to proceed by submitting the full testimony for the record.

Senator MOYNIHAN. Please do. It will be put in the record as if read.

Mr. DELFICO. Thank you.

I am pleased to be here before you today to discuss the Social Security Notch issue and the recent report of the National Academy of Social Insurance. I share your concerns about the implications of the Notch issue for the Social Security program.

We have reviewed the study of the National Academy and find it to be an expert analysis that enhances the public record. Furthermore, I am pleased to note that the findings of the study agree and

confirm the findings of our lengthy analysis of the Notch issue that we reported on last spring.

Since Mr. Myers, in his testimony, has detailed the technical issues so well I will not dwell on them except to summarize a few key points about the Notch issue.

First of all, largely as a result of the flaw in the automatic adjustment procedures adopted in 1972, replacement rates under Social Security rose steadily through the 1970s jeopardizing the financial stability of the system. Congress corrected the formula in 1977 and decided that future replacement rates would be set at levels prevailing in the mid-1970s.

Congress decided that the new benefit formula would affect those born after 1916, the so-called Notch group, but not those born before 1917. Because those who were born just before the Notch group benefited from the flawed formula, they were overcompensated compared to the Notch and future cohorts of retirees.

The Notch issue, notwithstanding, what should be remembered is that the basic purpose of the benefit formula revision in the 1977 amendments was to stabilize future replacement rates. In our view, this purpose has been achieved.

Nevertheless, the past several Congresses has seen numerous legislative proposals to correct the Notch and increase benefits for those under the new rules. We can expect that such proposals will surface again in the 101st Congress. These proposals raise pragmatic and complicated questions of costs—who pays, who benefits, and whether a legislative solution can be administratively feasible.

Legislative proposals to address the Notch carry substantial costs. The Social Security Administration estimated that additional payments to beneficiaries through 1996, under various proposals introduced in the 100th Congress, range from about $20 billion to over $300 billion. Additional costs could continue after 1996. For the most part, proposals to diminish the Notch lack specific financing methods. This implies using current trust fund balances to pay higher benefits. However, using these balances to finance higher benefits to Notch recipients would slow the system's attainment of a minimum contingency reserve level and could put the system at additional risk should be experience an economic downturn in the next few years. Reducing current trust fund balances also adversely affects the system's long run actuarial balance.

Other options for financing Notch remedies involve either increasing revenues through payroll taxation or reducing other expenditures, such as by slowing the growth of benefits for those under the old law. This option has the advantage of reducing benefits to those retirees who were overcompensated under the old law. But it has been considered in the past and it has been rejected. It would require that Congress reassess its decision in 1977 not to affect the benefits of those attaining eligibility before the new law's implementation in 1979.

The option of raising payroll taxes presents additional complications. Because of the 1983 amendments to the Social Security Act, current workers are paying higher payroll taxes than previous workers who financed the system on a pay-as-you-go basis. Imposing additional taxes on these current workers to finance a higher replacement rate for the Notch group —many of whom are already

receiving higher replacement rates than can be anticipated by current workers— raises another significant equity issue.

In deciding whether to adopt Notch legislation, other factors relating to the matter of who benefits should also be considered. Because of social security cost-of-living increases that out paced wage increases, many Notch retirees benefited relative to non-retired groups from the inflation of the late 1970s and the early 1980s. Thus, while those in the transition may be worse off relative to those born immediately preceding them, in many instances, they gained relative to the current workers who are now contributing to pay their benefits.

While the elderly have become better off as a group over time, we recognize that many remain poor. However, Notch legislation is not likely to do much to make the poor better off. The pattern of Notch disparity and the data on income and assets we examined, suggests that the Notch legislation will tend to benefit those who, on the average, have higher retirement incomes and greater asset holdings. Furthermore, those who tend to be poorer in health are more likely to have lower lifetime earnings and retire early and thus experience a small benefit disparity.

Another matter concerns the length of the transition period. The original 5 year period provides adequate notice of the changes to the new benefit formula. Extending the transition would draw more individuals into the controversy and could extend higher benefits to those who now come fully under the new law formula. In our opinion, that extension of the transition period is not warranted.

One additional matter with which the Congress should be concerned is the implementation of Notch legislation. Although we were not asked to focus on this aspect specifically in our March 1988 report, discussions with SSA staff suggest that implementation of Notch remedies might be difficult. Depending on the form of the legislation, SSA could be required to perform recomputations for millions for recipients. Practical limitations of the agency's computer software could require that many recomputations be performed by hand. This would place an additional burden on an agency that has experienced recent staff cuts and resource cuts and could require additional expenditures or reallocations of agency resources. We believe that Notch legislation should not be adopted without careful consideration of SSA's ability to implement it efficiently and effectively, and bear the associated administrative costs.

The Notch presents the Congress with a difficult policy decision. The benefit disparities can be large, but the facts show that their seriousness depends on the perspective one adopts. Those who argue that a Notch is unfair compare the benefits of the Notch group to the group of retirees which was the most overcompensated. Alternatively, as our work, and that of the National Academy show, when viewed in a broader historical context, many of those in the transition or Notch group fared quite well especially relative to those born before 1910 and after 1921. On balance, an objective examination of the facts suggests that the case for inequity resulting from the 1977 amendments is not a compelling one.

Finally, the case for the Notch must be evaluated in terms of the current realities of Social Security finance and the Federal budget. The agenda of the 101st Congress will be dictated by the need to put our Nation's fiscal house in order by reducing the budget deficit. Absent offsetting adjustments, increases in the Social Security benefits will necessarily add to the projected budget deficits and in slowing the growth of the trust fund reserves, this will delay the attainment of adequate contingency reserve levels.

In recent reports we have recommended that no action be taken that can reduce the current accumulation of Social Security trust fund reserves, at least until such time as adequate contingency reserve levels are achieved. Current projections show that such a level will be attained in the mid-1990s.

Thus, regardless of the perceived merits of addressing the Notch issue, doing so may not be a prudent course of action at this time, in light of the need to reduce deficits, meet pressing national needs and maintain the Social Security system on a path toward financial health.

That completes my prepared statement, Mr. Chairman. I would be pleased to respond to your questions.

[The prepared statement of Mr. Joseph F. Delfico appears in the appendix.]

Senator MOYNIHAN. Well, sir, that is very characteristic of the GAO to get its position clear and present it succinctly. I think the most important thing we heard was that the GAO is in complete accord with the National Academy, in your report last year and their report later in the year. We are in that situation where everyone is entitled to their opinions but the facts seem to be quite clear.

Let me just turn first to Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman.

I wonder, Mr. Delfico, if you could turn to page 7 of your testimony where you have a statement that I wish you would amplify, if you might. That is, in the second full paragraph, starting the third sentence. "The pattern of Notch disparity and the data of income ... suggests that Notch legislation will tend to benefit those who, on average, have higher retirement incomes and greater asset holdings."

On what do you base that?

Mr. DELFICO. Senator Chafee, we studied the Social Security Administration's New Beneficiary Survey which asks a series of questions about assets and holdings of new beneficiaries. They also asked questions about their health. We base that statement on our analysis of the retirees who are considered in the high income group and noted that their assets are quite a bit higher than those in the low income groups. They also are the ones that are hurt the most by the Notch issue.

If you recall, when Mr. Myers was here before me, he mentioned that those who have retired around 62 see very little impact of the Notch issue.

Senator MOYNIHAN. Yes.

Mr. DELFICO. But those over 65 do. Well, the ones who retired at 65 were higher earners. They also, according to our study, on the

average, had higher assets and income from other earnings in retirement.

So our finding was basically that the people who were hurt the most were the ones that had higher assets and higher earnings in retirement, not the poor.

Senator CHAFEE. Is it, in your studies, it would seem you indicate that those with lower incomes retire earlier. I should think it would be contrary.

Mr. DELFICO. No, not necessarily.

Senator CHAFEE. I should think it would be those with higher incomes might retire earlier. Or put it the other way, those with lower incomes would keep working to 65 because they needed the money.

Mr. DELFICO. There are a couple of reasons for that, Senator Chafee. One is that those who retire early could be in poor health. As a matter of fact, I think a large number of the people who retire early, even before 62, are either disabled or in poor health and do not want to continue the work after 62. So It drives the averages down.

Ken, is there any other point on that?

Mr. BOMBARA. No, I think I agree with that.

Senator CHAFEE. Well, when you are working with 50 percent of your working population retiring at 62 obviously they are not all in bad health. I would hope not.

Mr. DELFICO. No, they are not. But one of the things that drives the averages down is the health factor. In addition to that, studies have shown that the trends to early retirement have increased. I think the average early retirement age nowadays is around 61 for people with private pension plans.

Senator MOYNIHAN. Oh, is that right?

Mr. DELFICO. It is dropping.

Senator MOYNIHAN. Mr. Bombara, have you made a study of this?

Mr. BOMBARA. Many people retire at 62 because the incentive to keep on working is not as great as opposed to taking a Social Security benefit that gives them some income and they do not have to work. There are many other reasons also.

Senator MOYNIHAN. And in private pension systems, 61. Are people more and more coming out?

Mr. DELFICO. More and more like that. The private pension systems could have an earlier retirement age. A lot of them do allow retirement at 55. You can get out of a private pension system early.

Senator CHAFEE. I was interested in what you said about the difficulty of the calculations. I am not sure which page that was on. It might have been on page 6. I think you said somewhere in here that trying to calculate this is not so easy.

Mr. DELFICO. I think that was on page 8.

Senator CHAFEE. Is it page 8?

Mr. DELFICO. Yes. That's right.

Senator CHAFEE. Practical limitations.

Let me ask you one more question. Because this, I think, is an overriding consideration—that is, the solvency of the fund. I do not think any of us who are interested in the Sanford legislation cor-

recting this problem are suggesting an increased tax. Certainly I am not. An increased tax on the working people, an increased Social Security tax.

What is a sound fund as you look forward to it. Because there are so many variables out there. Obviously, the unemployment rate of the United States directly affects the Social Security fund in a phenomenal fashion. Am I not correct?

Mr. DELFICO. True. The employment rates do affect the calculations.

Senator CHAFEE. On both ways—greater income coming in, less disbursements going out.

Mr. DELFICO. Exactly.

Senator CHAFEE. And that is one of the reasons the fund is so strong now because the economy is strong and people are working.

You mentioned in your testimony, Mr. Delfico, that you expected this to reach the solvency level you wanted in the mid-1990s.

Mr. DELFICO. That is correct.

Senator CHAFEE. Do you show a chart on what is the right solvency level?

Mr. DELFICO. What we have recommended in the past is between 100 and 150 percent contingency ratio. What that means is that the fund will have enough assets at the end of the year to cover all outgo, or all payments, the following year without considering any revenue income. That is 100 percent contingency ratio. To have enough at the beginning of the year to make all your payments.

Senator CHAFEE. For the year. And you said 150 or 100?

Mr. DELFICO. Yes. Between 100 and 150 percent.

Senator CHAFEE. So it will cover for between a year and a year and a half?

Mr. DELFICO. Yes.

Senator CHAFEE. I see.

Mr. DELFICO. Yes. A year and a year and half's contingency ratio on hand.

Senator CHAFEE. I see. Okay.

Thank you, Mr. Chairman.

Senator MOYNIHAN. May I say to my colleague that the GAO under Mr. Delfico's direction has produced a report which we will be receiving this week on the growing trust fund reserves. It is an illuminating one.

I found that very important testimony. I think your chart shows very clearly the fact that, I guess persons born somewhere between 1909 and 1920 all have a higher replacement rate than people before them or after them.

Mr. DELFICO. That is true.

Senator MOYNIHAN. They just got lucky, that is all.

Mr. DELFICO. That is true.

If you were an average earner, then that is what this chart shows.

Senator MOYNIHAN. That is what that chart would show you. Well, I think that is very important. Some day this Committee is going to have to talk about this whole question of early retirement.

Ms. Ekstrand, did you have something you wanted to tell us?

Ms. EKSTRAND. No. I think that it has been pretty well covered.

Senator MOYNIHAN. You have just done the job.

We thank you all very much. The GAO is a remarkable institution and has remarkable persons in it. We are fortunate and we hope none of you takes early retirement.

Mr. DELFICO. Thank you, Mr. Chairman.

Senator CHAFEE. Mr. Chairman, while we are changing and the next panel comes on, it is fascinating sociologically what is happening in America with these early retirements. In a way, you would hate to think that people are doing it because either they are in bad health or they find their job so boring they cannot wait to get out of them. That is distressing.

Senator Moynihan. Well, maybe we never should have acquired Florida from the Spanish.

Senator CHAFEE. Well, that is true in my State. As soon as they retire they head for Florida, individuals seem to.

Interesting, at the same time that we have enacted legislation which indeed prohibits forcing retirement at any age, the trend is the exact opposite direction.

Senator MOYNIHAN. Just the opposite.

Let us think about whether that is not something we should hear about later on.

Our next witness, and a very welcome one, is Mr. Eugene Lehrmann, who is vice-chairman of the Board of Directors of the American Association of Retired Persons.

Mr. Lehrmann, we welcome you. Is there an associate you would like to bring up to join you?

Mr. LEHRMANN. They will be right here to advise me in case I make a mistake.

Senator MOYNIHAN. If you get it wrong, they will tap your shoulder.

Good morning, sir, and welcome. If I may say, just for the record, I think it is the case that the American Association of Retired Persons now has some—your membership, sir, it is some phenomenal number, is it not?

Mr. LEHRMANN. Twenty-nine million members, sir.

Senator MOYNIHAN. Twenty-nine million members. That would make you the largest membership organization in the Nation. Would it not?

Mr. LEHRMANN. Well, it is very close. I think there is one, it is a religious organization.

Senator MOYNIHAN. Non-religious group, yes.

Mr. LEHRMANN. Yes, I guess we are the largest group.

Senator MOYNIHAN. I wish I could be sure we had that many members in the Democratic party. And you are probably thinking about the Republican party, you would settle for that.

Senator CHAFEE. I would take 50 percent.

Senator MOYNIHAN. Sir, would you proceed.

STATEMENT OF EUGENE LEHRMANN, VICE-CHAIRMAN, BOARD OF DIRECTORS, AMERICAN ASSOCIATION OF RETIRED PERSONS, MADISON, WI

Mr. LEHRMANN. Thank you very much, Mr. Chairman.

I am Gene Lehrmann from Madison, Wisconsin; a member of the Executive Committee of the American Association of Retired Per-

sons (AARP). I have served on AARP's National Legislative Council for a period of 5 years and am also a member of the Board of Directors of the AARP's vote program.

AARP appreciates the opportunity to present its views regarding the so-called Social Security Notch. Since I was born in 1917, I am well acquainted with the concern you have because it affects me personally and my wife personally. As a result of misinformation about the intent and the impact of the 1977 Social Security Amendments, those born between 1917 and 1921 believe they are being discriminated against and petitioned Congress for a change.

AARP, along with an overwhelming majority of organizations representing older persons, maintain that Congress acted responsibly and appropriately in 1977 when it changed the overly generous benefit formula adopted in 1972.

Furthermore, the Association believes legislation to change current law is not needed. As pointed out in both the General Accounting Office (GAO) and the National Academy of Social Security Insurance reports, those born between 1917 and 1921 are not being cheated. They receive a fair benefit.

Legislation to change the current law and raise their benefits represents a serious threat to the long-term integrity of the Social Security trust fund. Lacking any financing mechanisms, these proposals would siphon off trust fund reserves which cushion today's retirees against an economic downturn and which also are accumulating in anticipation of the retirement of our children and grandchildren, especially the 77 million baby boomers.

Those who seek a change in current law assert that the 1917 to 1921 cohort received less favorable treatment than those born before and after them. However, both GAO and the National Academy reports show the transition group's benefits may be higher and certainly not lower than those born after them.

Those born between 1912 and 1916 received a bonanza and do better than all other beneficiaries. Yet this is not an acceptable rationale for perpetuating a costly mistake that threatens the integrity of the trust fund. Those in the transition group feel especially aggrieved, because they insist upon comparing dollar benefit amounts. However, it is misleading, in my judgment, to compare benefit amounts. A Social Security benefit is not a guarantee of a fixed dollar amount. Instead, it replaces a portion or a percentage of a worker's earnings lost due to retirement, disability or death.

Moreover, a benefit amount reflects a number of other factors unique to each worker. They include a person's work history, level of earnings, age of retirement, and year of birth.

Some supporting a change claim that additional benefits would help the economically vulnerable. Both reports conclude there is little, if any, gain for low income people for a change in the 1977 law. The vast majority of benefits from a change would flow with those with higher lifetime earnings. In fact, a much more effective way to help low income older persons is to make improvements in the supplemental Security Income program.

In conclusion, the Association continues to believe that we cannot sacrifice the interests of current and future retirees to meet the demands of a small group of beneficiaries. Tampering with the system for the advantage of this group endangers the integrity of

the Social Security system. A program which affects all Americans—workers, retirees, the disabled, and their families.

Thank you very much, Mr. Chairman.

[The prepared statement of Mr. Lehrmann appears in the appendix.]

Senator MOYNIHAN. Mr. Lehrmann, that was a straightforward proposition. It seems to me that the AARP, which certainly properly claims to be the largest organization in dealing with the concerns of retired persons, with a general and a—if I may say—clearly documented record of responsibility about the trust fund.

You make two points, I take it. One is that you accept the findings of the two reports we just heard from. You say that we really should look to replacement rates. If you see the charts that the GAO gives us, the replacement rates for persons the Notch years are higher than the ones for those who follow them. So would it be the case—would I be wrong to think that if you start fooling around with the present situation you will just create a new Notch later?

Mr. LEHRMANN. You will create a new Notch somewhere, Senator. That is what we are indicating—that any adjustment will change things. Then there will be a new Notch and new situations. What we are looking for is equity if there is any kind of change.

Senator MOYNIHAN. The point you make about supplemental security income with respect to persons with low income. We heard you there. Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman.

I am not sure that I agree with you on creating another Notch. If you look at Chart 3 of Mr. Myers testimony. You will see that—and again, we are talking not with the 62 because as Mr. Myers said and I think you will probably agree, Mr. Lehrmann, if everybody retired at 62 we would not be here.

Mr. LEHRMANN. That is right.

Senator CHAFEE. But they are not. And if you look at Chart 3, you will see, for example, that the low point on the replacement rate—and if we can agree here—that the key thing is the replacement rate. That is the statistic that people should be talking about. Not dollars, but the so-called replacement rate.

Now, if you look at Mr. Myers' Chart 3, you will see that it does dip. You start at 51, go down to 46.6, 45.7, 42.7, 40.8. That is your low point. Then you come up again to 40 and it pretty well stabilizes at 41.1, rising in 1988 to 41.4. So not that it is gigantic but there is a low point.

First of all, I think you are correct. The Chairman was referring to the GAO, Mr. Delfico's testimony. He has a replacement chart. What your point was, and the Chairman's was, that even those who are losing out as it were, their replacement rate is higher than current beneficiaries. Except for—and I do not know when they would be born, wherever those people, 65 from 85, well, 1920—they hit the low point. Not by much, but they are lower.

The other question I would like to ask is what you say in the top of page 2 of your testimony. "Lacking a financing method . . . ." Now, I do not think anybody is suggesting a financing method. In other words, I think all of us—at least myself—are saying we want to fix this if possible but we are not going to endanger the system.

And we are not suggesting an increased levy on the working people—current workers.

These proposals would siphon off trust fund reserves which condition today's retirees against an economic downturn and which also are accumulating in anticipation of the retirement of those born in the post-World War II baby boom. Now, that is the question before the House. Can the system afford some kind of correction? You say, no.

Mr. LEHRMANN. That is correct, Senator. We are saying no because any change that we make affects somebody else. It might even affect all present retirees if the economic situations change significantly.

Furthermore, we as AARP people have grandchildren and we have children. And any adjustment we are talking about also means somewhere further down the line when our children and grandchildren retire that there will be less resources available for their retirement purposes than would ordinarily be there. Even though it does not look like a very big amount right now, when one carries it out over 20 or 30 years, it is a significant impact then. We certainly feel that the situation has to be looked at very carefully. If anything is done at all, it has to be considered in terms of equity.

Senator CHAFEE. The point I want to make is that, I agree with you that it has got to be done with consideration of the reserves for the future. We all have children and grandchildren and are worried about the future. Some of the figures on the reserves of the Social Security fund, because of the full employment we have now plus other factors, are astonishing, as you know. I wish we could get some better figures on what this might cost to do something.

Give us a variety of figures. If you do "A", it costs "X"; if you do "B", it costs "Y"; and so forth. Because on that we can make our judgment. Perhaps later witnesses will give us some. I know it is a fuzzy area. Plus, there are these other problems that came out in the previous testimony about can you identify the people mechanically.

Thank you, Mr. Lehrmann.

Senator MOYNIHAN. Thank you, Senator Chafee. I think I might notice that it is quite so that we are on a good track with respect to the trust funds for OASDI.

But, Mr. Lehrmann, I suspect you would probably share with us the rather doleful prospects for health insurance. I see your colleagues behind you are nodding.

Mr. LEHRMANN. Yes, indeed. We share that.

Senator MOYNIHAN. We are going to be talking about some inter fund transfers before too long, do you not think?

Mr. LEHRMANN. Well, it is certainly something that has to be studied and AARP will take a look at the matter, Senator.

Senator MOYNIHAN. You will be looking at it. I want you to know that you are always welcome in this hearing room. We take great satisfaction in the care with which you present your materials and your sense of the universe of the retired persons and those to come, and not just one particular group.

Again, sir, we thank you very much. We will be back with you on a number of these subjects. Thank you for coming from Madison in the middle of winter. It is very thoughtful of you.

Mr. LEHRMANN. Thank you very much.

Senator MOYNIHAN. I mean, if you can survive Madison in the middle of winter you can do anything, I guess. It is a nice escape.

Mr. LEHRMANN. It is a little bit of a break.

Senator MOYNIHAN. And now, our next witness is Mr. Eric Shulman, who is the Director of Legislation for the National Council of Senior Citizens here in Washington.

Mr. Shulman, we welcome you. I wonder if I could just ask that you would describe the National Council for us, not that we do not know, but we would like to have the record clear.

STATEMENT OF ERIC A. SHULMAN, DIRECTOR OF LEGISLATION, NATIONAL COUNCIL OF SENIOR CITIZENS, WASHINGTON, DC

Mr. SHULMAN. Sure, Mr. Chairman.

The National Council of Senior Citizens is an organization of affiliated chapters, clubs and State councils throughout the Nation. Through our affiliated network of organizations we represent some 4.5 million older Americans. We have been around since about 1961 and, indeed, were born in the fight to establish the Medicare program.

NCSC is concerned about the issue of the Notch. We, like you, have received numerous inquiries, concerns, complaints, letters, about our position on the Notch. I should say at the outset that we do not believe that any of the current legislation, or the legislation that had been introduced last year with respect to the Notch, ought to move forward.

It seems to me that much of this legislation attempts to rectify a nonproblem. It is clear from the past testimony earlier this morning that although there is much confusion and controversy over the Notch issue, there is no fundamental injustice being done to Notch babies. For the most part, as has been said, the replacement rate for Notch babies is indeed higher than it will be for all future retirees.

If, in fact, there is any injustice within the Notch group of people, it is also clear that to solve the problem we should not be dipping into the trust fund. We should not be considering payroll tax increases. That, in fact, we should be looking toward those retirees who received the unintended bonanza prior to the onset of the Notch.

I am not suggesting that we go ahead and do this. I suspect that it would simply create an additional political problem rather than solve one that currently exists.

Rather than read through my testimony which basically says much of the same thing that the National Academy has said——

Senator MOYNIHAN. We will put it in the record as if read.

Mr. SHULMAN. I appreciate that, Mr. Chairman.

I would only make a few brief points. One is that this is obviously not the first hearing, nor even the second or third hearing on this particular issue. We have testified, as has AARP, and numerous other organizations and experts have testified on this issue sev-

eral times over the past few years. From those hearings one ought to be able to discern that the vast majority of experts in the field of social insurance and organizations that have been around for a long time, that represent the interests of the elderly, as well as workers, labor unions, a wide of range of organizations, are all virtually unanimous in their opinion that indeed, this is not the problem that some have suggested it is.

We feel that there are risks to moving forward with legislation that would tap the growing trust funds. To answer your question, Mr. Chafee, we cannot offer any specific documentation as to what the impact would be on the Social Security trust funds in the future years. We do know that Social Security has gone through some difficult periods. In 1977 and again in 1983.

We think that it is critical that we leave the trust funds alone, by and large to build—not only to pay for the benefits of baby boomers—but also to help build confidence among younger people in the Social Security system which is legitimately a concern among a great number of younger people.

Senator MOYNIHAN. Mr. Shulman, could I interrupt you there.

Mr. SHULMAN. Sure.

Senator MOYNIHAN. You raise a point which this subcommittee is just continually baffled by. It remains the case 50 years after Social Security began, it has never been a dollar short or a day late. It has been a remarkably successful program. A majority of non retired Americans do not think they are going to receive it. It may be that the pay-as-you-go system is not inherently trustworthy and that the current building up of funds will help. But it is a puzzlement, is it not?

Mr. SHULMAN. Yes. I would respond to that by saying, it would be interesting to look at polls of younger peoples' faith in Social Security prior to 1977 when we went through a financing crisis due to larger problems in the economy. Then to look at the 1983 financing crisis, which perpetuated a whole series of stories about the imminent bankruptcy of the Social Security system, and had a major effect on the confidence level of younger people on the system.

Senator MOYNIHAN. Well, I guess, as a matter of fact, the Director of the Office of Management and Budget in 1981 said the world's largest bankruptcy was going to come in the following October. You might be interested, and the audience might be, that we will have legislation—which we hope to have hearings on—that will send out once each year, at the end of the year, a report to the persons paying their Social Security on how much they have paid that year and what their accumulation is and an estimate of future benefits.

I think it is the case now—I guess I started paying Social Security in 1942 and I have yet to hear from them. I do not know whether they know my name or they have my accounts. I think if you got that annual report it might have—it is the sort of thing that by about age 35 you would start keeping them, if you know what I mean.

Mr. SHULMAN. I agree with you. I think that would do much to encourage people to realize that Social Security is there and that it intends to pay the full benefits that it owes you when you retire.

Senator CHAFEE. Well, I am all for that. Actually, I wanted it sent out this year in late October because in late October——

Senator MOYNIHAN. In late October.

Senator CHAFEE. In late October. I thought it would be very, very informational. It times nicely. I have heard the statistic about people do not have confidence in Social Security and I do not question the Chairman's report of 50 percent. But that is one of those statistics you hear that 80 percent of the people do not know who their Congressman is or only 50 percent know who is President of the United States.

I do not know who they are asking these questions of or how they are worded. But it is one of those things that I as a politician who is around and see my constituents do not find that kind of lack of faith. Maybe we are a more trustworthy—I should say optimistic group—in Rhode Island than elsewhere. But this statistic that the 50 percent of whatever it is—again, I do not question it, that it is there—and I do not know what group they are polling.

What did you say, young people?

Senator MOYNIHAN. No, non-retired adults.

Senator CHAFEE. Non-retired adults.

Senator MOYNIHAN. It keeps coming up.

Senator CHAFEE. Again, I do not have much confidence in that.

Senator MOYNIHAN. I did not want to distract Mr. Shulman. But I think the question of confidence in the system is important.

Mr. SHULMAN. I do think that without arguing specific statistics, that among younger people, particularly people under the age of 30, there is some genuine lack of uncertainty about the future of Social Security. This should not, by the way though, be confused with their support for paying Social Security payroll taxes or even their general support for the Social Security system. It is more specifically a concern about whether the financial future of Social Security is solid and that, indeed, it will be able to pay some 20 to 30 years, or 40 years hence, the benefits that it is now making commitments to paying.

We find in surveys of young people, routinely, that they support paying the payroll taxes and that they support the Social Security system. But when asked the question, do you feel that the system will pay you your full benefits upon retirement, we do discern a great deal of uncertainty on that issue.

Well, I really only have a couple of more points to make.

Senator MOYNIHAN. Take your time. We interrupted you.

Mr. SHULMAN. One is, I am a little sorry that the Social Security Commissioner could not have been with us today. Because I think that the SSA has an important role to play with respect to this Social Security Notch issue. I, frankly, would like to see the Social Security Administration send out a clearly worded, easily understandable notice to all Social Security beneficiaries across the country that attempts to explain the Social Security Notch in layman's terms.

I think that it is doable. I do not think that it necessarily, or inherently, would have to add to confusion on Social Security. I believe that having the imprimatur of the Social Security Administration could do much to alleviate the problem that exists, or the

confusion that exists across the nation on this Social Security Notch question.

And finally, the last point that I would really like to make is that the Notch issue is tragic, from at least this one perspective. I think that it has served to deflect a tremendous amount of attention from some of the very real and very legitimate issues that confront older people in our society everyday.

We think that Congress ought to be looking very closely at the issues of, for instance, the supplemental security income and its benefit adequacy in dealing with the problems of the lowest income, older people. We think certainly that long-term care is a continuing problem for many, many of our older citizens in the United States. Certainly, we think that these issues—health care costs—these are all issues that have been with us for some time.

And to the extent that the Committees of Congress, and Members, have been forced to deal with trying to explain this difficult and complex Notch issue and have not been able to focus on some of these very real tragedies among older people in the United States is, indeed, quite unfortunate.

[The prepared statement of Mr. Eric A. Shulman appears in the appendix.]

Senator MOYNIHAN. That is a very serious observation, I think. We do have questions of long-term care. We are going to be addressing them this year. We do have the adequacy of SSI as a question. The sufficiency of our Medicare provisions and trust funds, The matter on the Notch that Mr. Myers had mentioned on the catastrophic insurance. Obviously, I am going to have to learn about that.

Mr. SHULMAN. We, too were interested in his comments.

Senator MOYNIHAN. I am sure you are. Because, as you said, the National Council began in the effort to bring about Medicare, which it successfully did.

Mr. SHULMAN. Right.

Senator MOYNIHAN. Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman.

Your wish that the Social Security Administrator would send out a document that would be simple and brief and thoroughly explain the Notch, I think presents an incredible problem. It is like when we were working on the Internal Revenue Code Reform. We found that there is a conflict between simplicity and fairness. If you want to achieve fairness in the code, it is very, very difficult to do it in a simple manner. Fairness equates with complexity. So that is a real challenge you have thrown out to the Social Security Commissioner.

Also, I do want to reassure you that, as far as your concerns about our attention being distracted from these other issues, particularly long-term care, I do not think that is quite so. We are spending a lot of time on that. The challenges there are multiple. They all revolve around money. And attempting to solve it is extremely expensive.

On the SSI, I think you have a point. I personally have not spent as much time on that. Maybe the Chairman has because he has been long interested in that. I think that is a good point.

As far as trying to do something about this Notch, I know you certainly have not equivocated. You have taken your position. But still, I think we have a real difficulty there that I hope we will pursue some more. I do not know what the Chairman's position is. But I wish we could get some cost estimates.

Mr. SHULMAN. I think we can and we will.

Senator CHAFEE. It is very hard to work on this without any kind of cost. I would hope we could get something along that line which would give us a far better indication of are we, indeed, threatening the system. Are we imperiling it in some fashion. But I would like to have some cost estimates to work on this.

Thank you.

Thank you, Mr. Chairman.

Mr. SHULMAN. If I could make a comment?

Senator MOYNIHAN. Please.

Mr. SHULMAN. It seems to me, Senator, that you are attempting to address a problem that really by in large does not exist. Or at least, it is not an equity issue. You may feel that among your constituents and certainly we feel among our members that a number of Notch babies want a higher benefit level as a consequence of the earlier 1977 legislation. But your pursuant, you know, of the numbers to try and find out how much would be necessary to resolve the problem implicitly suggests that we have a problem here. From an equity perspective, I submit that the problem is relatively small. That there are very few of the Notch babies who, in fact, have a legitimate claim to higher benefits.

Senator CHAFEE. You can say it is not an equity. But when you have two people who are side by side, who have contributed exactly the same amount, who have worked exactly the same number of years, the only difference being that one was born a year before the other and is receiving, in some instances, over $100 a month more. You are not talking people whose incomes are in the twenties. You are talking about people whose incomes are less than 10 or—let us say less than $10,000 a year. And $100 a month is a significant amount.

It is hard to say to those people, there's no problem here. You are getting more than you entitled to anyway and what is the complaint.

Mr. SHULMAN. I agree with you.

Senator CHAFEE. The complaint is that somebody else is getting a lot more. That is understandable. So, I do not want to just brush aside their concerns because they are very legitimate.

Mr. SHULMAN. Having spoken to numerous groups of Notch babies over the last few years, I certainly can sympathize with the difficulty in explaining the issue to them. They are not sympathetic regardless of the points that you make. I can only say that if you were looking at it from an equity perspective, probably the fairest way to go is to look at the bonanza babies and to try and somehow attempt to rectify the difference between what the bonanza babies were getting and what the Notch babies are getting. But not to take the money from future baby boomers or from higher payroll taxes or something like that.

I am not suggesting that that is neccsarily a solution. But, again, from an equity perspective, the bonanza babies did receive substantially more in benefits than, in fact, they should have.

Senator MOYNIHAN. Thank you, Senator.

Thank you, Mr. Shulman.

Let me repeat for the benefit of any who may have arrived later, after the hearing opened, that the Social Security Administration is not represented today for the very good reason that the officials that would have to clear testimony are not in place.

Mr. SHULMAN. I understand.

Senator MOYNIHAN. We are still in a little bit of a transition here. We will hear from them and we will ask them your question.

Mr. SHULMAN. I appreciate that.

Senator MOYNIHAN. That is going to be called the Shulman Inquiry.

Mr. SHULMAN. Thank you.

Senator MOYNIHAN. We very much appreciate your testimony, sir. And, we very much appreciate the National Council.

Now, we close this morning with the testimony of the Honorable Bruce Sumner who comes to us from California, I believe. It is Judge Sumner, is it not?

Mr. SUMNER. Yes, it is.

Senator MOYNIHAN. Judge Sumner, we welcome you. And you, of course, are representing the National Committee to Preserve Social Security and Medicare. You have a Mr. Allen Johnston——

Mr. JOHNSTON. Good morning, Senator. It is good to see you again.

Senator MOYNIHAN. We welcome you to the Committee.

Mr. SUMNER. He is our Director of Grassroots and Member Relations.

Senator MOYNIHAN. And you have charts which are very welcome as well.

Mr. SUMNER. Yes. They are being put up by Mr. Bill Lessard, who is our Director of Policy.

Senator MOYNIHAN. Mr. Lessard, we welcome you to the Committee.

Mr. LESSARD. Thank you, Senator.

Mr. SUMNER. Ali right. May I proceed?

Senator MOYNIHAN. Please do.

STATEMENT OF HON. BRUCE W. SUMNER, MEMBER, BOARD OF DIRECTORS, NATIONAL COMMITTEE TO PRESERVE SOCIAL SECURITY AND MEDICARE, NEWPORT BEACH, CL, ACCOMPANIED BY ALLEN JOHNSTON, DIRECTOR OF GRASSROOTS AND MEMBER RELATIONS, AND WILLIAM LESSARD, JR., DIRECTOR OF POLICY AND RESEARCH, NATIONAL COMMITTEE TO PRESERVE SOCIAL SECURITY AND MEDICARE, WASHINGTON, DC

Mr. SUMNER. Mr. Chairman, members of the Senate Finance Committee, I am Bruce Sumner, Vice-Chairman of the National Committee to Preserve Social Security and Medicare. I want to thank you for the opportunity to take part in this discussion of what the 5.5 million members and supporters of the National Committee consider a most serious injustice, the Social Security Notch.

I would ask that our written statement be made a part of the hearing record.

Senator MOYNIHAN. It will be done exactly as you would do in your courtroom. You may proceed exactly as you wish, sir.

Mr. SUMNER. Thank you, sir.

Mr. Chairman, I am particularly pleased to have this opportunity to explain why we feel so strongly that the report from the National Academy of Social Insurance—although commissioned by some members of this committee—fails to address the issue.

The National Academy document is a rationale for maintaining a status quo. It is not an unbiased study of the Notch in justice and whether it should be corrected. To find such a document, one needs to go back to the 1985 legislative analysis by the American Enterprise Institute entitled "Proposals to Deal with the Social Security Notch Problem."

I would like to offer a copy of that analysis to the Chairman and urge that it be made a part of the hearing record.

Senator MOYNIHAN. I very much appreciate that. This is AEI's work. They are well regarded in this body and we will most assuredly make it a part of the record as an appendix to your statement.

Mr. SUMNER. Thank you, sir.

This is not to denigrate the members of the National Academy Panel. Over their years of government service, the members of the Study Panel, and particularly its Chairman, have done yeoman service for older Americans and, indeed, for the entire nation. But let us be honest. They were not the ones to call upon for a study of the Notch. They had already made up their minds that the Notch is not a problem.

Both the Chairman of the National Academy of Social Insurance itself, and the Chairman of the Study Panel, had decided long ago that the Notch should not be corrected. In fact, they had so testified before Congress. Asking them to study an issue which they had already taken a position is akin to asking a Judge to hear an appeal from a man that he had convicted earlier.

The other point I think needs to be made, Mr. Chairman, is that I know that there are some—both inside and outside of Congress—who blame our organization for the groundswell of opposition to the Notch. To do so is to ignore a number of salient points, not the least of which is the fact that the National Committee is far from alone in its efforts to end to the Notch injustice. Many others feel as we do.

To imply that the effort to correct the Notch is being directed by the National Committee is presumptuous. My organization does not control the 25 Senators, including your colleague, Senator Chafee, who sought a correction of the Notch in the 100th Congress. It does not control the 13 State Legislatures, including the State of New York, which has sent memorials to Congress urging action on the Notch.

Organizations such as the Great Panthers, Veterans of Foreign Wars, Jewish War Veterans, Reserve Officers Association, American Bar Association, Catholic Charities, Retired Teamsters, and the National Grange, do not take their legislative agenda from the National Committee to Preserve Social Security and Medicare.

The battle to correct the Notch predates by several years the National Committee's involvement in the effort. Our efforts began in 1986. Yet, in its analysis issued a year earlier, the American Enterprise Institute said:

> Members of Congress regularly confront a multitude of Social Security problems. In recent years, however, none has plagued them more in town meetings and constituent mail than the Social Security Notch problem.

And finally, having had the opportunity to meet and talk with a number of Notch activists all across the Nation, I can assure you that if the National Committee were to disappear today, there would still be a strong Notch correction movement in this country.

What the National Committee has done is to serve as a clearing house, whereby activists in one area of the Nation can learn what is going on elsewhere. It has provided the forum at which activists learned of the need for a compromise, the need for a plan which restores equity to the benefit formula without undermining the stability of the Social Security trust funds.

And when Senator Terry Sanford introduced legislation which was fair, yet far less expensive than other Notch bills, the National Committee urged Notch activists all across the Nation to support it.

But what about the study that we are here today to discuss. Mr. Chairman, what is ignored in the National Academy of Social Insurance study and, indeed, in the earlier General Accounting Office study, is the legislative history of the Notch. It is abundantly clear from reading the Congressional Record that what resulted from the 1977 Social Security Amendments is not what Congress had intended.

The November 2, 1977 Congressional Record displays a table showing that the Senate expected a worker with average earnings, retiring in 1985, would receive some $267 a year more than a similar worker who retired in 1979. In fact, that worker is receiving substantially less.

Even more telling is the National Academy of Social Insurance's determination to blame the benefit disparity on unexpected inflation and the resulting windfalls in benefits given those who were born prior to 1917. To support its arguments, it only compares the benefits of those born in 1916 and 1917. But it takes the comparison no further. Perhaps because if you extend their reasoning to a comparison of benefits of those born in 1916 and 1920, even after the so-called windfall has been eliminated, there is still a Notch of 15 percent, or $87.60 a month.

No wonder the American Enterprise Institute analysis concludes, and I quote: "that's the report that we just submitted."

Senator MOYNIHAN. Yes, we have a copy here.

Mr. SUMNER. And they state in that report that:

> Even if the inflation assumptions made in 1977 had turned out to be accurate, however, the Notch would have existed. And in percentage terms, the benefit differences it created would not have been much smaller than those that arose. The fact is that the Notch arose directly from the provisions enacted in 1977, not from the unexpected economic conditions that followed.

If you study the benefit levels which result from adoption of the Sanford Bill introduced in the 100th Congress, you will note that his compromise raises benefits up to, but not over, the windfall

level identified by the National Academy. Therefore, the Sanford Bill would not put the trust fund in a deficit as compared to a complete correction.

The study by the National Academy of Social Insurance does nothing to settle the Notch issue. We urge the Congress, and particularly the members of the Senate Finance Committee, not to use the National Academy study as an excuse to once again put the Notch issue on the back burner.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Sumner appears in the appendix.]

Senator MOYNIHAN. Thank you, Your Honor.

I recall Senator Nelson's heroic effort to explain the 1977 legislation to all of us. At one point he turned to an aide when a Senator asked him, what does this mean. He turned to him and said: "Yes, you tell me, what does it mean. I never quite understood it myself."

Mr. SUMNER. Senator, that is why I brought two experts to answer some of the more technical questions.

Senator MOYNIHAN. Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman.

Mr. Sumner, Judge Sumner, are these in your testimony—these charts?

Mr. SUMNER. The results are.

Mr. LESSARD. Let me say the first chart, the one that shows average benefits for beneficiaries, the Sanford solution in red, and the line which is the windfall level identified by the National Academy of Social Insurance reports. This is how the Sanford solution would increase benefits.

Senator CHAFEE. My question is, do they show up? The top one is on page 9.

Mr. LESSARD. Yes.

Senator CHAFEE. Now, how about your second one?

Mr. LESSARD. The second one is not in our report. We have a separate table in our report to show the effect of the trust funds if you passed a Notch solution like the Sanford solution.

Senator CHAFEE. Why don't you make a copy of that, could you, and send it to us?

Mr. LESSARD. Certainly.

Senator MOYNIHAN. Yes. You could do that.

Senator CHAFEE. I think that would be helpful.

Senator MOYNIHAN. We might like to have it in our records.

Senator CHAFEE. You have obviously given some thoughtful testimony here. I want to go through it because it is along the lines as I have been thinking, as you know, from the questions I have asked here. I hope we can do some form of correction here. Whether we can or not will depend, obviously, on what the financial situation is. No one on this subcommittee, or the full committee, or probably in the United States Senate, wants to do anything to jeopardize the future of the fund in any fashion.

So that is why these proposed solutions and the cost of them are so important. The cost estimates are so important, certainly as far as I am concerned. I would like to do something if possible here.

I want to thank you very much, Judge Sumner for your testimony.

Mr. SUMNER. Thank you.

Senator MOYNIHAN. I think we do have the cost estimates in your presentation. I think they come to about $70 billion. Is that not about right?

Mr. JOHNSTON. Over a 10-year period. Yes, Senator, that is correct.

Senator MOYNIHAN. I will be very careful. Over a 10-year period, about $70 billion.

Senator CHAFEE. Where do you pick that up, Mr. Chairman?

Senator MOYNIHAN. Right here.

Senator CHAFEE. Now you have given the Chairman a copy of this second chart.

Senator MOYNIHAN. That is right.

Senator CHAFEE. And this is, you say, $70 billion over 10 years. But then what happens? I mean, that does not end the payments, does it?

Mr. JOHNSTON. No, Senator. But what you can see is, from the annual cost figures, that they do top out in the mid-1990s. So along about the turn of the century the annual cost of this particular solution—and of course Senator Sanford has not determined any legislation at this point in this Congress—but this particular solution, the cost would start to go down. The long-term cost estimates for this, over the 75 years, are 0.7 percent of payroll, which is between one and two percent of the amount of the reduction in benefits that was caused by the change in the benefit formula in 1977.

Incidently, Senator, over this 10-year period, while the costs of the legislation would be $65 or $70 billion, the trust funds will accrue approximately $300 billion in surpluses.

Senator CHAFEE. Now, does this include any one time—I think you said the chart does not reflect a payment of $5.5 billion in cost for retroactive benefits up to $1,000 per worker which was suggested in the Sanford Bill.

Mr. JOHNSTON. Correct.

Senator CHAFEE. You have eliminated that?

Mr. JOHNSTON. It is not shown on the chart, which we have noted on the chart that we did not lock it in, because it is not an annual cost. It is a lump sum cost.

Senator CHAFEE. I see. Okay.

Thank you very much. This is interesting work.

Senator MOYNIHAN. That is a very helpful addition to the record. I particularly want to thank you for not letting us ignore our friends at the American Enterprise Institute. Their views should be part of this matter.

I would like to say, if it is agreeable to my colleague, that I would like to see the GAO report included in this hearing record as well. I think then we will have all the documents. And we will have your particularly valuable cost estimates.

[The GAO Report appears in the appendix.]

Senator MOYNIHAN. Your Honor, we thank you for coming all the way from California.

Senator CHAFEE. One other question, if I might, Mr. Chairman.

The National Committee is supporting the Sanford Bill. Am I correct in that?

Mr. SUMNER. Yes, sir.

Senator CHAFEE. Okay.

Mr. SUMNER. If it is reintroduced, we support it.

Senator MOYNIHAN. As you know, we have not—as a courtesy to the new President—we will not introduce Bills until this coming Wednesday.

Mr. SUMNER. I understand.

Senator MOYNIHAN. But I expect you will see it there.

And the hour of noon having arrived, and thank you, Your Honor——

Mr. SUMNER. Thank you very much.

Senator MOYNIHAN. ——and your associates very much.

We thank Senator Chafee and thank all of our witnesses, and particularly I want to thank Mr. Lopez who arranged and managed this hearing so well.

And with that, the hearing will stand adjourned.

[Whereupon, at 12:02 p.m., the hearing was adjourned.]

APPENDIX

ALPHABETICAL LIST AND MATERIAL SUBMITTED

PREPARED STATEMENT OF JOSEPH F. DELFICO

Mr. Chairman and Members of the Subcommittee:

I am pleased to appear before you today to discuss the social security notch issue and the recent report of the National Academy of Social Insurance. I share your concerns about the implications of the notch issue for the social security program.

We have reviewed the study of the National Academy and find it to be an excellent, expert analysis that enhances the public record regarding the notch issue. Furthermore, I am pleased to note that the findings of the study agree with and confirm the findings of the lengthy analysis of the notch issue that we reported on last spring.[1]

THE FACTS OF THE NOTCH

The National Academy study should leave little doubt as to the basic facts underlying the notch issue.

The notch refers to differences in benefits received by individuals who have similar work histories and first become eligible for benefits just before or just after January 1, 1979, the date set for implementation of new benefit computation rules.

The need for new computation rules arose because of a flaw in the benefit computation instituted in 1972 which provided for automatic adjustment for inflation. For many individuals reaching the age of first benefit receipt, benefits in relation to preretirement earnings (replacement rates) began an unintended rise. This resulted from the pattern of wage and price increases experienced after implementation of the indexing procedure. This is shown in the chart attached to my statement. Furthermore, replacement rates for some retirees were projected to rise to unprecedentedly high levels.

A consensus developed to change the benefit rules and these changes were made in the 1977 Amendments. In changing the benefit rules, Congress had to make several important decisions. Among these were: (1) what replacement rate should be afforded future retirees and (2) to whom should the new computation rules first apply?

The Congress decided to set the replacement rate for an average earner, retiring at age 65, at about 42%, which was roughly the level prevailing in 1975-76. This decision meant that workers under the new system would receive higher replacement rates than had been afforded similar workers retiring in the late 1960s and early 1970s, but would not get as much as the old rules would produce for workers retiring in 1978 or 1979 (the pre-notch group). Since the new system was to become effective on January 1, 1979, the Congress also had to decide how to calculate the benefits of persons who would be eligible prior to January 1, 1979 (that is, those who were at least 62 years old on that date). The Congress decided that the pre-notch group should be allowed to use the old formula, even if it resulted in their getting higher benefits than similar retirees that came before, or would follow afterwards.

When it adopted the new benefit computation rules in 1977, the Congress was also concerned that the new rules might cause

significant changes in the benefit amounts to be awarded some workers who were close to retirement. It adopted a special transition benefit formula for persons reaching age 62 in the first five years after the new system went into effect. That formula provided an alternative computation that could be used to calculate retirement benefits, if use of the alternative resulted in higher benefits.

Not only could the retention of the old benefit formula allow some individuals to receive higher benefits but, an additional feature of this formula resulted in a significant increment in benefit amount from additional years of work past the age of eligibility for benefits (age 62). The new benefit rules and the transitional formula substantially reduced the gain from additional earnings after the age of eligibility.

In combination with the old, flawed formula, the rapid inflation of the late 1970s and early 1980s caused the benefits of the pre-notch group to rise even faster than had been expected, relative to those under the new rules. Furthermore, inflation exacerbated the gap between those who continued to work after age 62 under the old rules compared to those doing the same, but under the new rules.

The first group of age 65 retirees to which the new rules applied retired in 1982; they are the notch group. Workers who had always earned the average wage and retired in that year--as well as in the next several years--would have received the transition benefit, rather than the lower replacement rate which was to be afforded to those retiring in the late 1980s and thereafter. In the chart, we see that the replacement rates begin to fall for age 65 retirees after 1981, but they do not fall to the 42 percent level until 1984.

In summary, replacement rates under social security rose steadily through the 1970s, largely as the result of a flaw in the automatic adjustment procedure adopted in 1972. When the Congress fixed the formula in 1977, it decided that future replacement rates would be set at levels which were somewhat higher than prevailed in the early 1970s, but were lower than the formula would produce for persons retiring in the late 1970s. The notch group is the first group of retirees to have their benefits computed under the new law. They received lower replacement rates than did those who retired just before them, but because of the transition rules, many of them received higher replacement rates than those who will retire after them.

The basic purpose of the benefit formula revision in the 1977 Amendments was to stabilize future replacement rates. In our view, this was achieved.

CONSIDERATIONS IN EVALUATING LEGISLATIVE PROPOSALS

The past several Congresses have seen numerous legislative proposals to "correct" the notch and increase benefits for those under the new rules. We can expect that such proposals will surface again in the 101st Congress. These proposals raise pragmatic and complicated questions of cost, who pays, who benefits and whether a legislative solution could be administratively feasible.

Legislative proposals to address the notch carry substantial cost. The Social Security Administration estimated that additional payments to beneficiaries through 1996 under various proposals introduced in the 100th Congress ranged from about $20 billion to over $300 billion. Additional costs would continue after 1996. For the most part, proposals to diminish the notch lack specific financing mechanisms. This implies using current

trust fund balances to pay higher benefits. However, using these balances to finance higher benefits to notch recipients would slow the system's attainment of minimum contingency reserve levels and could put the system at additional risk should we experience an economic downturn in the next few years. Reducing current trust fund balances also adversely affects the system's long run actuarial balance.

Other options for financing notch remedies involve either increasing revenues through payroll taxation or reducing other expenditures, such as by slowing the growth of benefits for those under the old law. This latter option has the advantage of reducing benefits to those retirees who were overcompensated under the old law. But it has been considered in the past and rejected. It would require that Congress reassess its decision in 1977 not to affect the benefits of those attaining eligibility before the new law's implementation in 1979.

The option of raising payroll taxes presents additional complications. Because of the 1983 Amendments to the Social Security Act, current workers are paying higher payroll taxes than previous workers who financed the system on a pay-as-you-go basis. Imposing additional taxes on these current workers to finance a higher replacement rate for the notch group (many of which already receive a higher replacement rate than can be anticipated by current workers) raises another significant equity issue.

In deciding whether to adopt notch legislation, other factors relating to the matter of "who benefits" should also be considered. Because of social security cost-of-living increases that outpaced wage increases, many notch retirees benefitted relative to non-retired groups from the inflation of the late 1970's and early 1980s. Thus, while those in the transition may be worse off relative to those born immediately preceding them,

in many instances, they gained relative to the current workers who now contribute to pay their benefits.

While the elderly have become better off as a group over time, we recognize that many remain poor. However, notch legislation is not likely to do much to make the poor better off. The pattern of notch disparity and the data on income and assets we examined, suggests that notch legislation will tend to benefit those who, on average, have higher retirement incomes and greater asset holdings. Furthermore, those who tend to be in poorer health are more likely to have lower lifetime earnings and retire early, and thus experience smaller benefit disparities.

Another matter concerns the length of the transition period. The original five year period provided adequate notice of the change to a new benefit formula. Extending the transition period would draw more individuals into the controversy and could extend higher benefits to those who now come fully under the new law formula. It is our opinion that extension of the transition period is not warranted.

One additional matter with which the Congress should be concerned is the implementation of notch legislation. Although we were not asked to focus on this aspect specifically in our March 1988 report, discussions with SSA staff suggest that implementation of notch remedies might be difficult. Depending on the form of legislation, SSA could be required to perform benefit recomputations for millions of recipients. Practical limitations of the agency's computer software could require that many recomputations be performed by hand. This would place an additional burden on an agency that has experienced recent staff and resource cuts and could require additional expenditures or reallocation of agency resources. We believe that notch legislation should not be adopted without careful consideration

of SSA's ability to implement it efficiently and effectively , and bear the associated administrative costs.

SHOULD ANYTHING BE DONE?

The notch presents the Congress with a difficult policy decision. The benefit disparities can be large, but the facts show that their seriousness depends on the perspective one adopts. Those who argue that the notch is unfair compare the benefits of the notch group to the group of retirees which was the most overcompensated. Alternatively, as our work, and that of the National Academy show, when viewed in a broader historical context, many of those in the transition or notch group fared quite well especially relative to those born before 1910 and after 1921. On balance, an objective examination of the facts suggests that the case for inequity resulting from the 1977 Amendments is not a compelling one.

Finally, the case for the notch must be evaluated in terms of the current realities of social security finance and the federal budget. The agenda of the 101st Congress will be dictated by the need to put our nation's fiscal house in order by reducing the budget deficit.[2] Absent offsetting adjustments, increases in social security benefits will necessarily add to projected budget deficits and in slowing the growth of trust fund reserves, will delay the attainment of adequate contingency reserve levels. In recent reports we have recommended that no actions be taken that reduce the current accumulation of social security trust fund reserves, at least until such time as an adequate contingency reserve level is achieved.[3] Current projections show that such a level will be attained in the mid-1990s. Thus, regardless of the perceived merits of addressing the notch issue, doing so may not be a prudent course of action at this time, in light of the need to reduce deficits, meet other pressing national needs and maintain the social security system on a path toward financial health.

That completes my prepared statement, Mr. Chairman. I would be pleased to respond to your questions.

FOOTNOTES

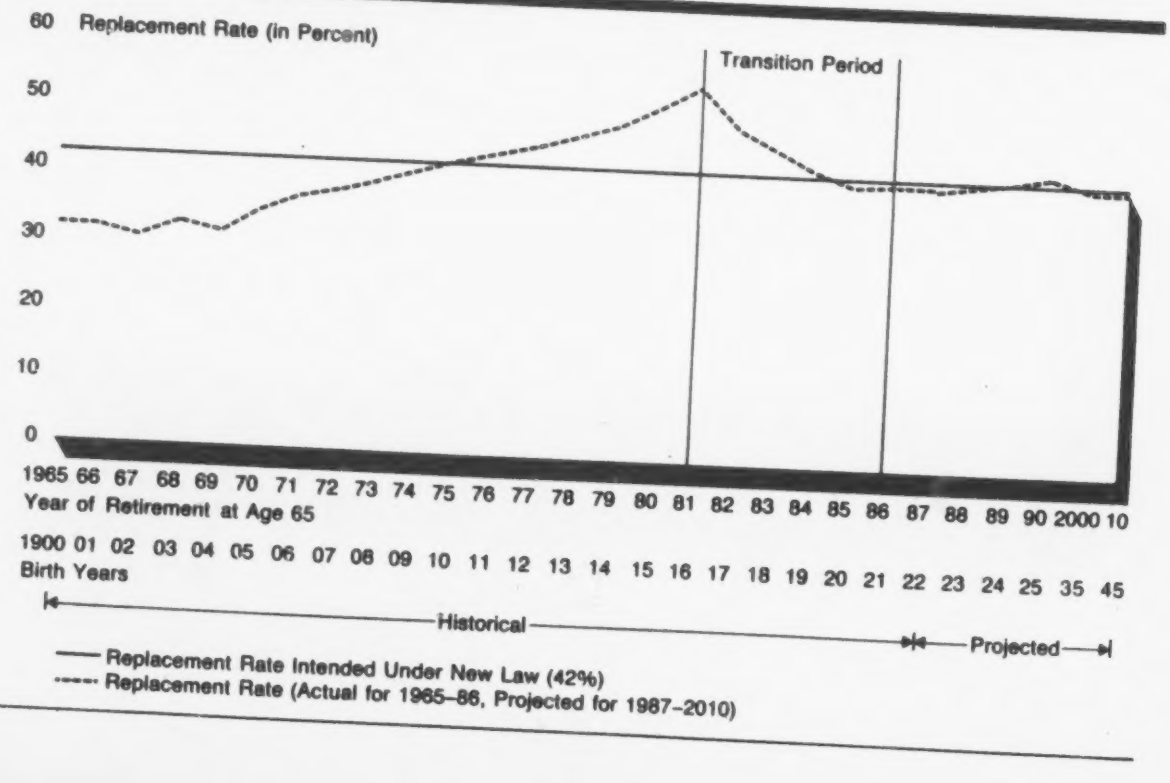
1 U.S.General Accounting Office, Social Security: The Notch Issue (GAO/HRD-88-62, Mar. 24, 1988)

2 U.S.General Accounting Office, The Budget Deficit (GAO/OCG-89-1TR, Nov.1988)

3 U.S.General Accounting Office, Health and Human Services Issues (GAO/OCG-89-10TR, Nov.1988)

GAO

Replacement Rates for an Average Earner Retiring at Age 65, 1965–2010


60
Replacement Rate (in Percent)
50
40
30
20
10
0
Transition Period
1965 66 67 68 69 70 71 72 73 74 75 76 77 78 79 80 81 82 83 84 85 86 87 88 89 90 2000 10
Year of Retirement at Age 65
1900 01 02 03 04 05 06 07 08 09 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 35 45
Birth Years
Historical
Projected
Replacement Rate Intended Under New Law (42%)
Replacement Rate (Actual for 1965–86, Projected for 1987–2010)

REPORT OF THE GENERAL ACCOUNTING OFFICE

UNITED STATES GENERAL ACCOUNTING OFFICE

REPORT TO CHAIRMAN, SUBCOMMITTEE ON SOCIAL SECURITY, COMMITTEE ON WAYS AND MEANS, HOUSE OF REPESENTATIVES

SOCIAL SECURITY—THE NOTCH ISSUE

March 24, 1988

The Honorable Andy Jacobs, Jr.,
Chairman, Subcommittee on Social Security,
Committee on Ways and Means,
House of Representatives

DEAR MR. CHAIRMAN:

This report responds to the request of your predecessor, the Honorable James R. Jones, for a review of a disparity in benefits, known as the notch, between cohorts of social security recipients that resulted from the Social Security Amendments of 1977. Specifically the report discusses how the notch arose, its effects on beneficiaries, the financial implications of some proposed notch legislation, and the socioeconomic characteristics of affected social security recipients.

We are sending copies of the report to the Secretary of the Department of Health and Human Services and to cognizant Congressional committees. Copies will be made available to others who request them.

Sincerely yours,

CHARLES A. BOWSHER,
Comptroller General of the
United States

EXECUTIVE SUMMARY

PURPOSE

Social security retirees born just before 1917 generally receive higher benefits than those born in 1917 and after—a disparity commonly referred to as the notch. Pre-1917 birth retirees were compensated at an unexpectedly high level because of the way increased inflation affected the ±benefit formula. This resulted from the introduction of an automatic cost-of-living adjustment in the 1972 Amendments to the Social Security Act.

Continued use of this benefit formula would have jeopardized the solvency of the Social Security Trust Funds and required large future increases in payroll taxes to pay for the growing benefits. Faced with this problem, in 1977 the Congress corrected the formula, in effect reducing benefits for retirees born after 1916. For nearly a decade, these retirees have voiced their concerns to the Congress that they have been treated unfairly.

Because of the continuing controversy, the Chairman of the Subcommittee on Social Security, House Committee on Ways and Means asked GAO to study the issue. Specifically, the Chairman asked GAO to review:

- how the notch arose,
- how beneficiaries are affected,
- alternatives for financing legislation to address the issue, and
- socioeconomic characteristics of those affected.

BACKGROUND

Before 1972, the Congress adjusted social security benefits on an ad hoc basis. The 1972 Amendments to the Social Security Act changed the benefit formula to provide automatic adjustment for cost-of-living changes. But the method of adjusting benefits, combined with prices rising faster than wages caused future retirees' benefits to be overindexed—increased by more than the rate of inflation.

A consensus developed to revise the benefit formula. After considerable debate, the Congress passed the 1977 Amendments to the Social Security Act. The new formula was designed to eliminate overindexing and stabilize replacement rates (the portion of an individual's preretirement earnings the retirement benefit replaces).

New benefit rules were instituted for individuals attaining benefit eligibility (age 62) on or after January 1, 1979. As the new rules could result in lower benefit levels, a transitional payment strategy was developed for retirees born between 1917 and 1921. Benefits for these retirees were computed using both the transitional formula and the new rules, and they received the higher benefit. Those born after 1921 received benefits computed using only the new

rules. These transitional retirees, born in 1917–1921, have become known as the notch group.

RESULTS IN BRIEF

The 1977 Amendments, in altering the formula that had benefited some social security recipients born before 1917, stabilized replacement rates and lowered their level. But in the process, many retirees born in 1917 and thereafter received smaller benefit amounts than those born just before them. The rapid inflation of the late 1970s and early 1980s increased the size of the benefit differences between these groups.

Among those retiring at age 62, differences in benefit amounts were generally small. But these differences were larger for those who retired after age 62.

While the replacement rate for notch retirees is generally lower than that for individuals born immediately before them, it is generally higher than the replacement rate for succeeding groups of retirees.

Legislative proposals to lessen the benefit disparities are costly and could be difficult administratively. Solutions that would draw money from the trust fund to increase benefits to the notch group could jeopardize the short-run financial condition of the system and its ability to finance the coming retirement of the "Baby Boom" generation. Other options would require reducing the growth of benefits to those already retired, which the Congress chose not to do in 1977. While GAO does not support any specific notch legislation, it offers guidelines for any further congressional consideration of the issue.

GAO'S ANALYSIS

Lowering of Replacement Rates Intended

Benefit disparities resulted mainly from the new rules. As anticipated, these rules lowered replacement rates by from 5–10 percent and separated old-formula from new-formula retirees by birthdate.

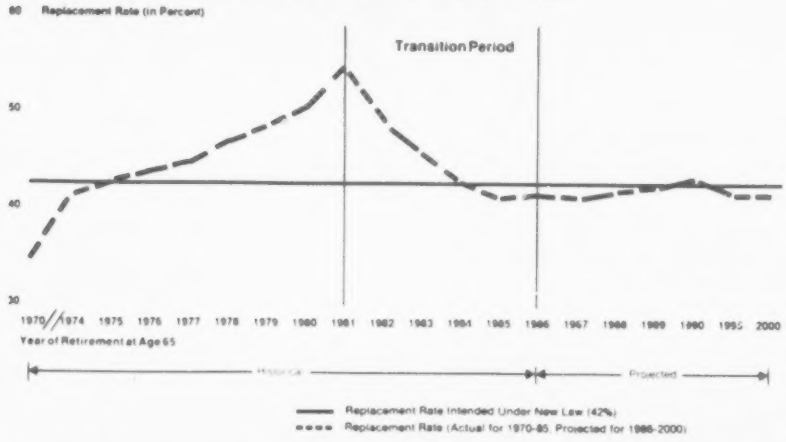
Higher Inflation Contributed to Disparities

Inflation in the late 1970s and early 1980s was higher than had been anticipated, causing the benefits of those under the old formula to increase more rapidly than was expected. This reduced the effectiveness of the transition formula, which was designed to cushion the adjustment to the new law. In turn, this increased the benefit differences between the notch group and those born immediately before them. The differences are greater for beneficiaries with higher lifetime covered earning and later retirement ages.

While overall replacement rates were lowered by the 1977 law, the rates received by notch retirees were generally higher than had been expected when the law was passed. Also, the replacement rates of those attaining eligibility age (62) just before and during the transition generally were higher than the rates of many retirees historically and of those retiring after the transition. Thus, a person born in 1917, the first year of the notch group, and retiring at age 65 received a lower percentage of preretirement earnings

than a person born in 1916. But the replacement rate for this retiree is higher, for example, than for one born in 1922, the first year after the transition period, (see fig. 1).

Figure 1: Replacement Rates for an Average Earner Retiring at Age 65, 1970-2000



Proposals to Diminish Notch Costly and Risks Remain

Legislative proposals to diminish the notch disparity have been introduced, but their cost is a major point of debate. Additional payments to beneficiaries through 1996 could range from about $20 billion to over $300 billion. Using current trust fund balances to finance notch remedies would slow the attainment of minimum contingency reserve levels and could put the system at additional risk should there be an economic downturn. Also, the Social Security Administration, in light of continued efforts to cut its costs and staffing levels, believes implementation of notch remedies might be difficult.

Past Congressional Actions Affect Financing Options

Other options for financing notch remedies from the trust fund would involve either increasing revenue (through payroll taxation) or reducing other expenditures, such as slowing the growth of benefits for those under the old law. The Congress has considered these options in the past and rejected them. Under 1983 legislation, current workers (who would be taxed to pay higher benefits to notch beneficiaries) already pay higher taxes than would be necessary under the pay-as-you-go concept to partially fund their own future benefits and reduce future workers' tax burden. Imposing additional taxes on these current workers to finance a higher replacement rate for the notch group (many of which already receive a higher replacement rate than can be anticipated by current workers) would raise significant issues of equity. As another alternative, it has been proposed that benefits to the pretransition group be reduced or their growth slowed to permit increased benefits for notch retirees. Such proposals however, would require the Congress' to

reassess its decision in the 1977 Amendments not to affect the benefits for those who attained eligibility for benefits before the new law was implemented in 1979.

Other Factors to be Considered

In deciding whether to compensate notch beneficiaries, factors other than benefit disparities also should be considered. Because of social security cost-of-living increases that outpaced wage increases, many retirees generally benefited relative to nonretired groups from the inflation of the late 1970s and early 1980s. Also, in comparing the notch disparity with patterns of income, assets, and health status, retirees likely to experience larger disparities have, on average, higher incomes and more assets. Those who tend to be in poorer health are more likely to experience smaller benefit disparities.

MATTERS FOR CONGRESSIONAL CONSIDERATION

GAO suggests that the Congress, in deciding whether or not to pursue a legislative solution for the notch issue, consider:

- keeping the effect of notch legislation on the current and projected trust fund balances as neutral as possible,
- evaluating the resources and time required for implementing the legislation, and
- retaining the current transition period.

AGENCY COMMENTS

Overall, the Department of Health and Human Services agreed with GAO's findings. The Department said, however, that more emphasis should have been placed on the overcompensation of retirees born just prior to 1917. GAO believes that the issue is sufficiently discussed. See appendix VIII.

CHAPTER 1—INTRODUCTION

The social security "notch" is a term used to describe a disparity in benefit awards between individuals who share similar circumstances concerning the computation of their benefits except that their birth dates differ slightly. Following is an example, presented at a recent Congressional hearing,[1] of the disparity.

Two sisters, Edith and Audrey, started work at the same book bindery in southern California on the same day in October 1957. Audrey was slightly older, having been born in March 1916, than Edith who was born in June 1917. The two worked together at similar pay for twenty five years and in the summer of 1982, with Edith turning 65, both went to the Social Security office to claim their benefits. They were told that since the older Audrey had worked about eighteen months after her 65th birthday, there would be a slight difference in the benefit each received. The total lifetime earnings of the pair was almost identical differing only by about four per cent (in favor of the younger Edith). To their surprise, when they received notification of their benefit award, the difference was not slight. Instead, Edith (born in 1917) received a $512.60 monthly award or *$111.80 per month less* than Audrey (born in 1916) who received a higher benefit of $624.40 per month. The difference was almost eighteen percent!

Examples such as this characterize discussions of the notch and underlie concern about the fairness of our nation's social insurance program.

THE NOTCH: A COMPLICATED TECHNICAL ISSUE

The clarity of examples that illustrate the notch contrast rather sharply with the complexity of factors underlying the problem. The history and development of the issue are rooted in changes enacted by the Congress over the years in the way social security benefits are calculated. In particular, the 1972 and 1977 Amendments to the Social Security Act are relevant. In each instance, the design of the benefit formula changes interacted with unanticipated economic conditions to affect benefits in a way different than what was expected.

The 1972 Amendments instituted automatic benefit indexing for changes in prices—"cost of living adjustments" (COLAs). While this was considered a desirable development, the changes also created the potential that periods of rapid inflation (during which prices increased more rapidly than wages) such as that of the 1970s would increase significantly the initial benefits of persons retiring subsequently. Efforts to correct this situation led to enactment of the

[1] Hearing on the Social Security notch before the House Select Committee on Aging, May 15, 1986. GAO did not examine lifetime earnings or benefit data related to this example.

1977 Amendments, which again revised the benefit formula. The 1977 revision of the benefit formula was considered to be consistent with a more stable, predictable long-run financing situation for the social security system. But making a transition to the new benefit rules presented some complications. The new law covered those attaining age 62 in January 1979 and later. Transition rules were adopted for those attaining 62 in 1979 through 1983 (i.e., those born in 1917 through 1921). These transition rules were expected to smooth the transition from the old (pre-1977) to the new (post-1977) formula, gradually reducing the levels of unanticipated overcompensation for succeeding retirees. For individuals turning 62 after 1983, the new rules were fully applicable. Those turning 62 before 1979 were permitted to continue to use the generally more generous pre-1977 formula computation.

After implementation of the 1977 changes, it was discovered that some individuals in the transition group were likely, after a few more years of work, to receive considerably lower benefit amounts than those receiving benefits based on the old formula. This was true even when the earnings' history and other characteristics of the individuals were nearly identical. The notch, then, refers to the disparity in benefits for individuals comparable in characteristics but born in closely adjacent years, which determine the applicability of different benefit formulas. As the effects of the new law and transition provisions became apparent, debate ensued over whether further changes to the benefit formula should be made and, if so, what form they should take.

NOTCH MAY AFFECT MILLIONS OF BENEFICIARIES

It has been claimed that the notch affects upwards of 10 million beneficiaries who come under the transition rules, the number depending on how it is defined. There is some disagreement about definition.[2] Moreover, the effect may vary among individual recipients. For some, benefit differences can be well over $100 per month. On the other hand, some individuals who believe their benefits are lower may in fact not be affected at all or even may have received higher benefits relative to other recipients.

Legislation designed to reduce the disparities between pre- and post-1979 retirees may affect millions of workers who contribute to social security under its current cost-financing (pay-as-you-go) concept. Concerns about cost have characterized the social security program for the past decade in particular and were a major consideration in the enactment of reforms in the 1977 Amendments and in 1983 legislation. In 1977, the revision of the benefit formula could not be separated from concerns about the financial status of the system. Likewise, legislation to address the notch issue cannot be considered apart from concerns about cost as well as who pays and who benefits.

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[2] Social Security Administration (SSA) data indicate that as of December 1986 the number of retired worker beneficiaries on the rolls (in current payment status) born during the period 1917–1921 totaled 6.6 million.

POLICY CONTROVERSY, PRACTICAL CONSTRAINTS

During the past several years, there has been continuing interest in the notch issue. Thousands of benefit recipients have lobbied the Congress to address the issue. Many in the Congress have responded by introducing or cosponsoring legislation to change the computation of benefits or to study the issue further. Interest groups for the elderly have taken different sides. The National Committee to Preserve Social Security and Medicare has made correcting the notch a major initiative. The American Association for Retired Persons (AARP) recently took a position against enactment of notch legislation that would require additional financing. Many retirees who depend on social security for a large share of their income are concerned about this issue, one important to the future of social security and the public's perception of the system's fairness. At the same time, any "solution" must deal with some significant problems of an administrative nature that generate other issues and difficulties in implementing legislation.

OBJECTIVES, SCOPE, AND METHODOLOGY

The notch issue was debated during the 99th Congress. Subsequently, the Chairman of the Subcommittee on Social Security, House Committee on Ways and Means, asked GAO to conduct a comprehensive study of the issue.[3] James R. Jones, then Chairman, asked GAO to review:

- how the notch arose
- what beneficiaries are affected by it, and
- what alternatives exist for financing legislation to address the issue

During our review, we surveyed literature on the notch issue as well as the relevant history of changes to the social security benefit formula dating back to the 1972 Amendments. We consulted with SSA officials and others knowledgeable about the issue. Most of the data are from the Social Security Administration. Among other materials used were analyses by Robert J. Myers, former SSA Chief Actuary, and the American Enterprise Institute. We concentrated on the technical and policy aspects of the issue but did not study how or whether notch legislation could be effectively implemented. We began our work in the summer of 1986 and completed the major portion of it in the fall of 1987.

In addition, the subcommittee requested information on the socioeconomic characteristics of those affected by the notch. Of particular concern was the economic and health status of those most likely to benefit from notch legislation. We utilized data from SSA's New Beneficiary Survey (NBS) to assess the characteristics of those affected by the notch. For further detail on our methodology and data, see chapter 7 and appendix II.

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[3] See app. I for request letter.

CHAPTER 2—THE SOCIAL SECURITY BENEFIT FORMULA BEFORE THE 1977 AMENDMENTS TO THE SOCIAL SECURITY ACT

To analyze the development, causes, and effects of the notch benefit disparity requires a review of the history of changes to the social security benefit formula. The notch arose out of the changes instituted in the 1977 Amendments to the Social Security Act to correct unanticipated effects of the 1972 Amendments. The 1972 Amendments first instituted the practice of automatic benefit indexing (i.e., cost-of-living adjustments or COLAs). The 1972 changes, in the context of inflationary conditions in the 1970s, led to the recognition that the benefit formula contained a flaw that could overcompensate future retirees and, if left unchanged, eventually threaten the financial stability of the social security system.[1]

OVERVIEW OF THE SOCIAL SECURITY BENEFIT FORMULA

The overall structure of social security[2] benefits encompasses many detailed elements and different conditions. For example, Old-Age, Survivors' and Disability Insurance (OASDI) covers individual retirees, but also provides benefits for their spouses, dependents, and survivors, as well as for disabled persons. Benefits for these latter groups may be affected by the legislated changes from which the notch issue arose, but we focused on the computation of benefits for individual retirees based on their own earnings' record.

The basic element in computing individual social security benefits (including those of dependents and survivors) is the "primary insurance amount" (PIA). Computation of the PIA involves two basic steps:

1. Calculation of the *benefit base.* This is derived from the reported taxable earnings of the worker in social security-covered employment over a specified period of the worker's employment history.[3] From this may be excluded a number of

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[1] For a more detailed description of the calculation of Social Security benefits, see various SSA publications, including *Social Security Bulletin, Annual Statistical Supplement,* 1986. Also see Robert J. Myers, *Social Security,* Richard D. Irwin, Inc., 1985. Furthermore, much of the discussion in this chapter is based on information from numerous documents and studies. Among the more useful in discussing the problems in the benefit formula are: Colin D. Campbell, *Overindexed Benefits: The Decoupling Proposal for Social Security,* American Enterprise Institute, 1974; Robert S. Kaplan, *Indexing Social Security: An Analysis of the Issues,* American Enterprise Institute, 1977; and Lawrence H. Thompson, "Toward the Rational Adjustment of Social Security Benefit Levels," *Policy Analysis,* Vol. 3, No. 4, Fall 1977, pp. 485–508. These studies provide discussion of many detailed technical points that cannot be fully developed here.

[2] The term "social security" is a broad one encompassing not only OASDI but Medicare (both Hospital Insurance and Supplementary Medical Insurance) and other elements of our social welfare system. Generally, reference to "social security" in this report will be to Old-Age and Survivors' Insurance (OASI), and to Disability Insurance (DI) where noted.

[3] The individual's covered taxable earnings, not payroll taxes, are reported by way of the income tax system to the Internal Revenue Service, and to SSA. Payroll taxes paid by individ-

Continued

years of low earnings. The covered taxable earnings then are summed and averaged to provide a measure of the average monthly earnings. The benefit base provides a measure of the level of earnings attained by a worker over his/her lifetime for purposes of benefit computation.

2. Application of the *benefit formula* to the benefit base to compute the *PIA or benefit amount.* This formula represents the percentages of the benefit base within given brackets that can be awarded as benefits. The endpoints of the brackets in the benefit formula usually are referred to as "bendpoints," and a given percentage will apply to the amounts within the brackets. In its simplest terms, the PIA is calculated as follows: benefit base x benefit formula = primary insurance amount. A hypothetical example would be:

Avg. monthly earnings = $400

90% of first $100 of avg. earnings	=	$90
30% of earnings between $100 and $300	=	60
15% of earnings over $300	=	15
Primary insurance amount	=	$165

In this example, the worker's average monthly earnings during his/her years of work under social security is $400. Applying the benefit formula to this amount, the worker receives 90 percent of the first $100 of average earnings, 30 percent of the next $200 (the amount between $100 and $300), and 15 percent of the amount over $300, for a total PIA (or benefit amount) of $165.

THE BENEFIT FORMULA BEFORE THE 1972 AMENDMENTS

Before the 1972 Amendments, social security benefit formulas were not automatically adjusted for inflation. Instead, the Congress from time to time passed legislation raising benefit levels. Such ad hoc benefit increases could be considered in part as adjustments for inflation and in part as real increases in benefit levels. The benefit base then was called the average monthly wage (AMW). The benefit formula was applied to the AMW to obtain the individual PIA amount. For example, in 1969 the formula underlying the benefit table in the law (applicable for January 1970) was as follows:

81.83% of the first $110 of AMW
29.76% of AMW between $111 and $400
27.81% of AMW between $401 and $550
32.69% of AMW between $551 and $650

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uals are not per se reported and a record of the individual taxes paid into the system is not actually maintained. Thus, a common perception that individual tax contributions are held in a "social security account" is not accurate. Also, note that "taxable earnings" are the annual earnings subject to payroll tax. The current maximum taxable ceiling is $45,000. Earnings over this amount are not taxed for social security nor included in the computation of the benefit base.

For example, an AMW of $400 yielded a PIA of $176.31 (or $90.01 + $86.30).

The AMW was based on a worker's covered taxable earnings over his/her working life. Generally, this consisted of any earnings after 1950 summed and divided by the number of "computation" or averaging years (in months) of earnings, excluding several years of lowest earnings. The earnings used in the benefit base computation were unindexed.[4]

The benefit formula reflected the percentages of the AMW between certain bendpoints that were to be included in determining the PIA. Several things about this formula are important. *First,* the percentages of AMW included as part of the PIA tended to decrease for higher levels of AMW. This means that the formula "replaces" a relatively higher proportion of a lower earner's total AMW and a relatively lower proportion of a higher earner's total AMW. This was true even though individuals receive higher total benefits the higher their lifetime earnings and AMW. This characteristic, referred to as "progressivity" in the benefit structure, means that social security possesses a redistributive character. *Second,* the degree to which social security "replaces" a worker's earnings was largely determined by the percentages of the benefit formula. The replacement ratio or rate—the relationship of the PIA (or benefit) to a measure of the worker's preretirement earnings is a crucial concept in analyzing the benefit structure and its equity. It is also a concept that we used extensively in analyzing the notch issue. The use and limitations of the replacement rate are discussed in more detail in appendix III.[5]

Finally, during the earlier period of ad hoc adjustments, whenever the Congress legislated a benefit increase the benefit formula was adjusted to reflect the increase. The percentage increase passed by the Congress was applied to the benefit formula percentages for each bendpoint.[6] For example, when a legislated 10-percent benefit increase was set for 1971, the previous benefit percentages (applicable for 1970) were increased by 10 percent as shown below:

90.01% of the first $110 of AMW
32.73% of AMW between $111 and $400
30.59% of AMW between $401 and $550

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[4]The number of averaging years formerly differed for men and women but these differences later were eliminated. Also, the number of averaging years included in the formula was lengthening during this time. In addition, there was another computation method for benefits, the "old start" method, which permitted earnings before 1951 to be included in the computation of benefits. This method could be used for some individuals if it was appropriate and resulted in a higher benefit award.

[5] Much of the discussion and analysis in this report will relate to hypothetical, but representative, steady earnings' histories. In the analysis of social security benefit levels, it is common to use low, average, and high earnings' histories, assuming that a representative individual earned at the same relative level throughout his/her lifetime. Therefore, our discussion of benefits and replacement rates generally will center around three typical earning cases: (1) low earnings—earnings at minimum wage throughout a career, (2) high earnings—earnings at the maximum taxable amount throughout a career, and (3) average earnings—earnings at the average wage of all workers covered by social security. These typical cases provide a fairly consistent means of comparing individuals and their benefits across years.

[6] In successive years, whenever the maximum taxable ceiling increased, brackets were added to the table as necessary, thus raising the maximum allowable AMW and PIA.

35.96% [7] of AMW between $551 and $650

Thus, for an AMW of $400, the January 1971 formula yields a PIA of $193.96 (or $99.01 + $94.95), 10 percent higher than the 1970 PIA shown above for a year earlier.

THE BENEFIT FORMULA AFTER THE 1972 AMENDMENTS

Problems arose with the institution of the automatic cost-of-living adjustments introduced in the 1972 Amendments and higher rates of inflation, in which prices increased as rapidly (or even more rapidly) than wages. The late 1960s and early 1970s were characterized by higher rates of inflation than had been experienced for some time in the U.S. economy. The view became prevalent that the social security program could be improved through automatic adjustment of benefits for price change (i.e., indexing) to maintain the purchasing power of recipients' benefits. Often, the ad hoc adjustments were viewed as not timely in keeping the real purchasing power of retirees' benefits constant as the price level rose. Also, there was some desire to insulate the social security program from the political process where, it was perceived, there were incentives to raise real benefit levels.

In 1972, Congress amended the Social Security Act to provide for two principal types of automatic adjustments:

1. Benefits were to be increased automatically with changes in the Consumer Price Index (CPI) if the annual index rose by 3 percent or more.
2. The maximum taxable ceiling was to be automatically increased with increases in the average wage covered by social security.

The method applied to adjust the benefit formula under the new automatic adjustment provisions was the same as that used prior to the 1972 Amendments. That is, the automatic benefit percentage increase was applied to the percentages of AMW allowed in each bracket of the benefit formula. Also, as the maximum taxable ceiling increased, higher levels of wages were brought under the benefit formula. This increased the maximum benefit payable under social security.

These changes in the benefit formula meant that an individual's benefit level would rise with increases in prices (inflation) as well as with increases in average wage levels. This latter aspect already was an integral part of the benefit structure; for workers who earned less than the maximum taxable amount, their future benefit levels would rise as their earnings rose. For those earning above the taxable ceiling, future benefits would increase as higher earnings levels were brought under the rising taxable ceiling. This in itself did not constitute a problem. But when coupled with the way in which price changes affected the benefit formula, it created the potential for overindexing of benefits, depending on the relationship of future price and wage increases.[8]

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[7] For January of 1971, another bracket for the next $100 of AMW was added at a benefit percentage of 20. Thus, the maximum AMW was to be higher also.

[8] Under some sets of assumptions about future price and wage increases, underindexing of benefits could occur (i.e., replacement rates could decrease over the years).

OVERINDEXING AND INFLATION'S EFFECT ON WAGES AND THE BENEFIT BASE

Overindexing arose from the structure of the (indexed) benefit formula in the context of an inflationary economic environment. As previously described, under the benefit formula instituted in the 1972 Amendments, whenever a cost-of-living increase was granted, the percentage factors in the PIA benefit formula were increased by the same percentage. This resulted in maintaining the real purchasing power of benefits for retirees on the benefit rolls. It had the same effect for future benefit recipients not yet retired. In this sense, the system was said to be "coupled"—price changes affected the benefit determination of current retirees as well as current workers. However, inflation had another effect on the potential benefit levels of those yet to retire, one that operated through the benefit base (AMW). This made future benefit levels and replacement rates very sensitive to the relationship between the rates of wage growth and change.

Inflation affects the benefit base as it affects the growth of nominal (current dollar) wages in the economy. Generally, nominal wages are viewed as depending on two major factors: the productivity of labor, generally associated with increases in the real wages or earnings of workers, and changes in the price level.

To maintain the real purchasing power of a given nominal wage when inflation occurs, wages must rise by the same percentage increase as the rate of price change (i.e., cost of living).[9] During a period of sustained inflation, regular adjustments for price changes will be consistent with rising nominal wage levels. Under the post-1972 benefit formula, higher nominal wage levels would tend to raise the level of the unindexed AMW for individuals, resulting in higher expected future benefit awards.[10]

Inflation had a dual effect, resulting in higher future benefit levels for those yet to retire (as figure 2.1 shows):

- It resulted in increases in the percentages of AMW awarded as benefits in the PIA computation.
- As it drove up nominal wage levels, it raised the computed AMW for future benefit recipients.

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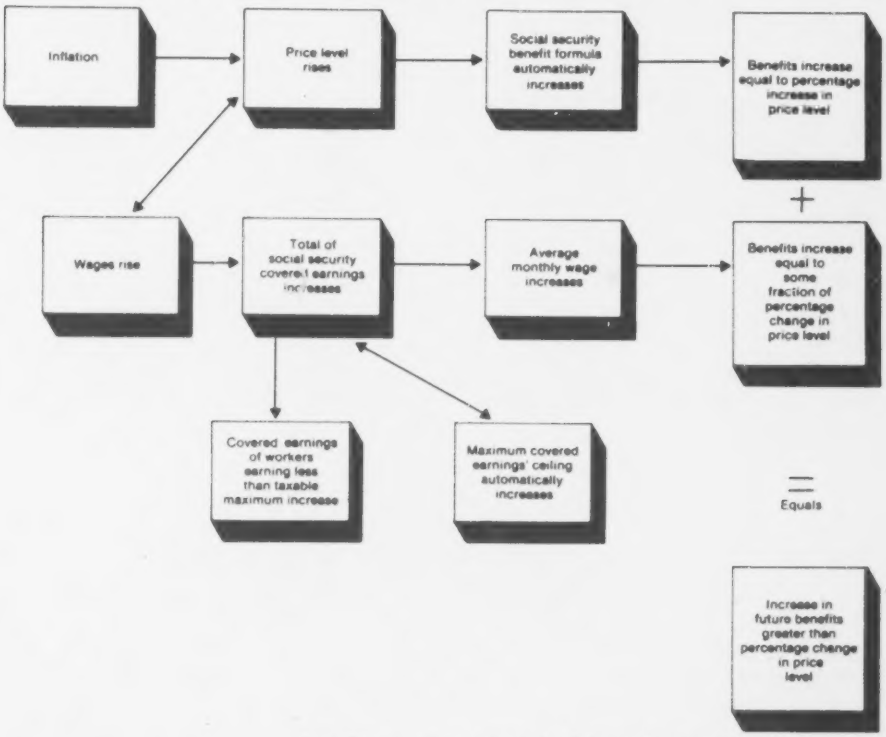
[9] While inflation usually results in higher nominal wages in the economy, such changes occur in an imperfect way. Actual nominal wage increases will not necessarily equal the rate of inflation over any given time period, and there will be variation in wages among occupations and industries.

[10] Also, rising wage levels result in a higher maximum taxable ceiling, which could mean higher benefit amounts for some individuals.

Fig. 2.1: Overindexing of Social Security Benefits Due to Inflation


Inflation
Price level rises
Social security benefit formula automatically increases
Benefits increase equal to percentage increase in price level
+
Wages rise
Total of social security covered earnings increases
Average monthly wage increases
Benefits increase equal to some fraction of percentage change in price level
Covered earnings of workers earning less than taxable maximum increase
Maximum covered earnings' ceiling automatically increases
=
Equals
Increase in future benefits greater than percentage change in price level

Source: Based in part on diagram found in Colin D. Campbell, Overindexed Benefits: Decoupling Proposals for Social Security, American Enterprise Institute, 1974, p. 8.

In effect, those who had yet to retire were receiving dual compensation for the effects of inflation. Once a worker retired and the initial PIA was computed, the individual only received increases equal to the annual cost-of-living adjustment. It was the benefit levels of those still working and yet to retire that were considered to be "overindexed" because of the "coupled" nature of the benefit formula, which linked the method of computing benefits at the time of retirement to the method of increasing benefits after retirement.

OTHER FACTORS AFFECTED FUTURE REPLACEMENT RATES

Other factors complicated the effects of overindexing on future replacement rates or, more specifically, the ability to predict future replacement rates. Some of these factors tended to lower future replacement rates, thus mitigating some of the effects of overindexing.

In computing benefits, the number of years of earnings that an individual could include in the AMW computation was lengthening, eventually to reach 35 years for those attaining age 62 after 1990. Thus, succeeding retirees used an additional year for averag-

ing in the computation of the AMW. During a period of rising nominal wages, the continual lengthening of the averaging period for successive cohorts slowed the growth in the AMW for any given earnings' history and tended to slow the growth in average replacement rates. While this mitigated the rise in benefits, the effect would largely have been diminished after the mid-1990s.

Another factor was a form of "bracket creep" due to the fixed wage brackets or bendpoints in the benefit formula. As an individual's wages rose, so did the AMW. In the progressive benefit formula, higher AMW amounts received a lower benefit percentage. Thus, replacement rates tended to fall as wages rose. This effect occurred even though the maximum taxable ceiling was adjusted automatically.

Another important characteristic of the benefit computation system in effect prior to the 1977 Amendments involved the effect of work in and after the year of attaining age 62 on retirement benefit levels. During periods of rapid inflation and rising nominal wages, the unindexed nature of the AMW meant that higher earnings near retirement could have a disproportionate effect on the AMW. This occurred because additional years of work after age 61 meant that a current year's earnings replaced a much earlier year's earnings, which were at substantially lower levels, in computing the AMW.[11]

Combined, these factors made future replacement rates very sensitive to the rate of real wage growth and to particular combinations of price change and nominal wage growth projected to occur in the future.

OVERINDEXING AFFECTED THE SYSTEM'S FUTURE SOLVENCY

With the inflation of the 1970s, the problem with the automatically indexed benefit formula came to be of great concern. A significant future problem was developing. For a given rate of real wage growth but higher rates of inflation, projections showed that the formula could lead to ever-increasing initial replacement rates. Some projections showed that, under projected annual rates of increases in prices of 4 percent and wages of 5.75 percent, replacement rates for some newly retired workers eventually would exceed 100 percent. That is, their initial monthly benefits could be greater than monthly earnings prior to retirement (see fig. 2.2). This was far above levels ever anticipated. Moreover, the adjustment procedure made future replacement rates very sensitive to the rates of price and wage change prior to a worker's retirement. Instability was introduced into both the determination of replacement rates and the future cost of the social security system.[12]

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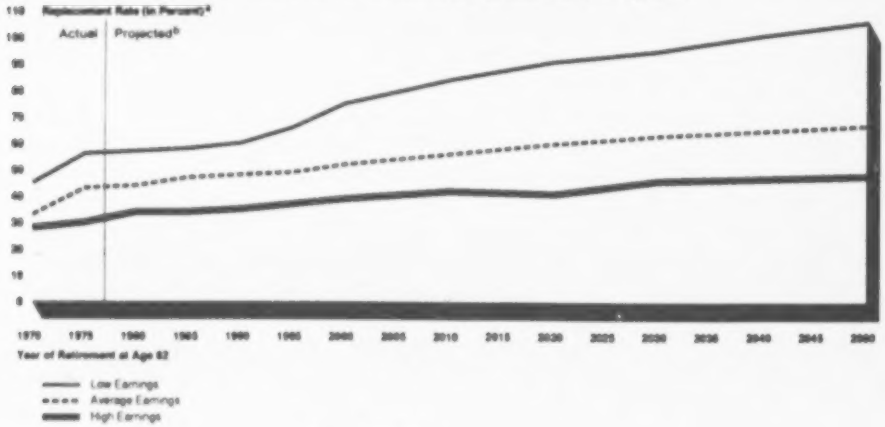
[11] Under the pre-1977 law, the number of years over which an individual's earnings were averaged equaled the number of years after 1955 and up to the year of attaining age 61. Thus if an individual worked past age 62, the earnings that year, if higher, could replace an earlier year in the computation of AMW. For example, the taxable maximum in 1975 was $14,100. This might replace earnings, in say 1955, when the taxable maximum was $4,200.

[12] The interaction of price and wage change for a given rate of growth in real earnings was quite complicated in its effect on replacement rates. For further technical discussion see Lawrence Thompson, *Policy Analysis*, and Albert Rettig and Orlo R. Nichols, "Some Aspects of the Dynamic Projection of Benefits under the 1973 Social Security Amendments (P.L. 93-233)," *Actuarial Note No. 87*, Office of the Actuary, SSA, Apr. 1974.

Figure 2.2: Projected Replacement Rates Under Pre-1977 Law for Age 62 Retirees by Earnings' Level



[a]Based on 100% of PIA

[b]Based on 1977 Trustees' assumptions

Source: House Report on H.R. 9346, 1977, p. 24

This effect on replacement rates created problems for the financing of the system by exacerbating already developing long-run financial difficulties resulting from changing demographic conditions. For example, it was projected that the increased expenditures from the trust funds as a percentage of taxable payroll would have to be matched by future payroll tax rates that, in some cases, might exceed 20 percent.[13] This generated concern about whether such rates would be viable and whether the system could maintain the support of taxpayers.

THE DECOUPLING DEBATE

The problem of overindexing became an important element in a broader debate on reform of the social security system that took place in the mid-1970s. An important outcome of this debate and highly technical discussion was the revision in 1977 of the benefit formula as well as other financing reforms. The term "decoupling" was applied to the objective of making the initial claim for benefits unrelated to the method of increasing benefits for changes in the price level for those already retired.

In attempting to change the benefit formula, the analysis of the pre-1977 benefit structure focused primarily on (1) the unindexed benefit base and (2) the adjustment of percentages in the benefit table. It was proposed that, in computing the benefit base, an individual's earnings' history be indexed. Each year's covered earnings would be adjusted to levels prevailing near retirement. That is, the earnings' history would be expressed in (constant) dollars relative to current earnings' levels, and the benefit base would represent the average of indexed earnings.

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[13] See Colin Campbell, *Over indexed Benefits . . .*, and Robert S. Kaplan, *Indexing Social Security . . . .*

Perhaps more important were changes in the benefit formula itself. This involved fixing (holding constant) the percentages of the benefit base used in computing the PIA and adjusting the wage brackets for changes in average wages and the taxable maximum. Holding constant the benefit percentage meant that the percentage of benefit base "replaced" no longer would grow with inflation. This was the key element of decoupling. In addition, by adjusting the brackets of the benefit formula, the bracket creep effect arising from the progressive benefit formula would be diminished, and real benefit levels could better keep pace with rising real wages. These key technical elements of decoupling were aimed at making future replacement rates more stable and predictable.

Although there was considerable debate over various technical issues and proposals, the policy debate centered on the role of social security in maintaining the incomes of the retired. This related to the appropriate replacement rate for retirees and whether the replacement rate should be constant, rising, or declining over time for successive cohorts of retirees. An important technical issue concerned how to index benefits (whether to prices or wages) as well as concern over the cost implications of the proposals for the system.

The first and perhaps most important proposal to surface came from the 1974 Advisory Council on Social Security.[14] This group of experts proposed a wage-indexed system for the benefit base and a benefit formula in which the percentages of the monthly wage awarded as benefits would be held constant. The Council's report recommended that the percentages allowed be set to keep benefits, hence replacement rates, at about "current levels," which can be interpreted as those prevailing at the time the report was presented (1974-75).[15] During this time, there were also proposals in the Congress to return replacement rates to about the levels prevailing in 1972. These issues and proposals set the stage for continuing debate, which led to the 1977 Amendments to the Social Security Act. It was from this background that the adopted amendments to the benefit formula and the transition provisions developed and from which the notch issue emerged.

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[14] There were other important discussions of decoupling. For example, proposals came from the Ford Administration, Robert J. Myers, and a panel led by Prof. William Hsiao, all suggesting alternatives and modifications. Notable is the Hsiao proposal to use price indexing rather than wage indexing in the revised benefit formula. This proposal would have led to declining aveage replacement rates and lower future costs for the system. For further detail, see Robert S. Kaplan, *Indexing Social Security . . ., pp. 37-47.*

[15] The percentages would have to be lowered considerably because the suggested wage-indexed benefit base would be considerably larger than the benefit base computed under the existing unindexed (AMW) method.

CHAPTER 3—THE EVOLUTION OF THE NOTCH ISSUE: TECHNICAL ASPECTS

The 1977 Amendments to the Social Security Act instituted a new benefit formula that was intended to lower and stabilize future replacement rates for beneficiaries. In moving to the new benefit formula, the Congress debated various provisions as well as procedures for implementing the new law, and transitional benefit computation provisions were adopted. Subsequent to the implementation of these provisions, it became apparent in computing benefits for some retirees that there could be disparities of varying sizes in benefit amounts depending on whether benefits were computed under the "old" (pre-1977) formula or the "new" (1977) law and transition provisions. These disparities underlie the notch issue.

CHANGES TO THE BENEFIT FORMULA IN THE 1977 AMENDMENTS

In enacting the 1977 Amendments (Public Law 95–216) in December 1977, the Congress addressed a number of issues.[1] Perhaps the most important change was the revision of the benefit formula. Five new benefit calculations were adopted. The most significant, and the one we focus on in the following discussion, was the wage-indexed formula, which for convenience we will refer to as the new benefit formula.[2]

Consistent with the goals of decoupling discussed in chapter 2, the 1977 formula represented a new method for calculating the benefit base by indexing the earnings' record to account for the change in average wages in the economy over a worker's career. The new benefit base computation was called the average indexed monthly earnings (AIME).[3] The AIME was to be applied to a new formula to derive an individual's PIA, as follows:[4]

90% of AIME up to $180, plus
32% of AIME over $180 and up to $1,085, plus

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[1] Regarding the program's financing, the 1977 Amendments introduced a new schedule of tax rates to raise revenue and provided for increases in the maximum taxable earnings' ceiling above what would have occurred through the automatic indexing provisions. The increase in the ceiling would generate more revenues for the system in the near term while increasing the benefit base in later years for some individuals, who would have more earnings counted in the computation of benefits. For a more detailed discussion of the provisions adopted in the 1977 Amendments, see Robert J. Myers, *Social Security*.

[2] The other formulas were the transitional guarantee, the regular-minimum, the 1977 old-start method, and the disability benefit guarantee. See Steven F. McKay and Bruce D. Schobel, *Effects of the Various Social Security Benefit Computation Procedures*, Actuarial Study No. 86, SSA, Office of the Actuary, July 1981.

[3] In calculating the AIME, the earnings for each year after 1950 are multiplied by the ratio of (a) the national average wage in the second year before eligibility to (b) the national average wage in the particular year. Then the highest indexed earnings for the specified number of "averaging" or "computation" years are averaged and divided by the number of months in these years. See McKay and Schobel, pp.3–4.

[4] The formula shown is applicable to those attaining first eligibility for benefits in 1979.

15% of AIME over $1,085.

The key characteristics of the formula are (1) fixed benefit percentages and (2) annually adjusted bracket widths or bendpoints based on the change in average wage levels. Once the initial PIA is determined at the date of first eligibility, subsequent increases in it are based on the annual cost-of-living adjustment.

These basic changes addressed overindexing. By fixing the benefit percentages, the new formula decoupled benefit determination for future retirees from changes in prices. The AIME computation addressed the problem of giving higher weight in the formula to inflation-induced wage increases that occurred near retirement. Adjusting the bendpoints by the change in average wages alleviated the "bracket creep" arising from having fixed bendpoints in a progressive benefit formula under the old formula. Essentially, the new wage-indexed formula meant that future retirees' PIAs would be driven by wage growth before age 62 and by price change after age 62.

LOWERING OF BENEFITS AND REPLACEMENT RATES

In the debate over revising the benefit formula, attention focused on setting the level of future replacement rates. The 1974 Advisory Council had recommended stabilizing rates at approximately the levels then prevailing; [5] some sought to return replacement rates closer to 1972 levels, before benefits were automatically indexed. The then-current administration considered setting future replacement rates at levels prevailing at the time of implementation of the new law.

Actually, in the adopted amendments, replacement rates were scaled back to eliminate some of the increase in benefits that had occurred since the early 1970's. It was anticipated that, when the new benefit provisions were fully implemented, replacement rates would be about 5 percent lower than the rate expected under the old law for a worker retiring at age 62 in 1979. This was reflected in lower benefit percentages in the new formula.[6] The anticipated effect of decoupling on the replacement rate for age 62 retirees (ignoring actuarial reduction) in various years, based on the economic assumptions employed in 1977, is shown in figure 3.1.

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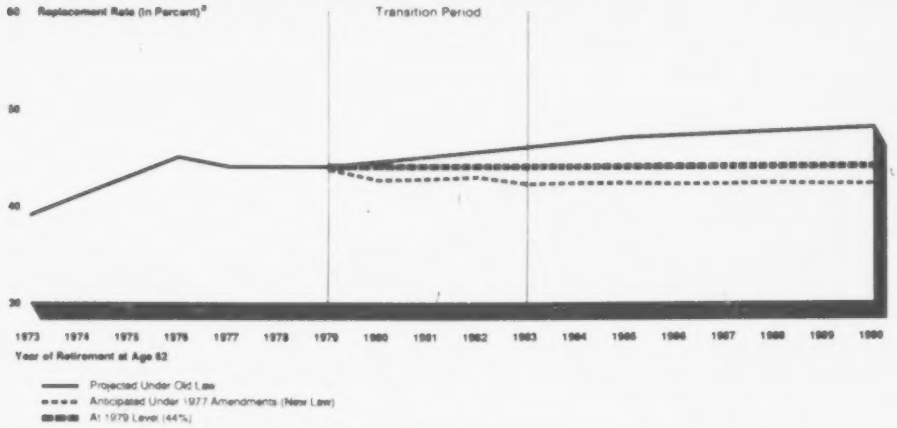
[5] Historical data show that the replacement rate in January 1975 for an individual with career average earnings retiring at age 62 (ignoring actuarial reduction was 42.3 percent; for a career low earner, 59.5 percent; for a career maximum earner, 30.1 percent. In close approximation, these were the replacement rate levels the Congress set about to achieve in the 1977 legislation. (Source: memoranda by Orlo R. Nichols, SSA, Office of the Actuary, dated April 7, 1987.) The projected replacement rates contained in the House report on H.R. 9346 were 55 percent for low earners, 43 percent for average earners, and 30 percent for maximum earners.

[6] Robert Myers notes that, "Both the Ford and Carter Administrations had recommended no ... reduction, but Congress did so (upon testimony to this effect by the life insurance business, supported by other business groups)." See *Myers*, p. 227.

Figure 3.1: Anticipated Effect of Decoupling on Replacement Rate for an Average Earner at 62



*Based on 100% PIA

Source: House Report on H.R. 9346 and SSA

Note: For period 1979-90, rates are projections based on 1977 Trustees' assumptions

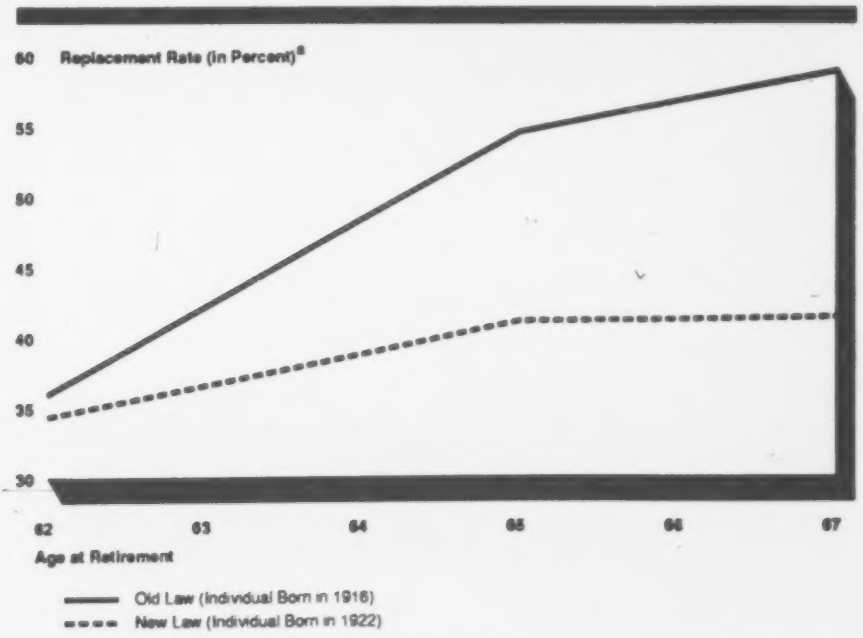
For various technical and policy reasons, the Congress also chose to index the earnings' histories of workers according to the time a worker initially becomes eligible for benefits (age 62) rather than the time of retirement. As a result, earnings after age 60 are not indexed; rather, these earnings are counted at their nominal value, and individuals use the benefit formula applicable to them at age of eligibility, regardless of the actual year of retirement.[7] Individuals do, however, receive the benefit of all CPI increases that occur in and after the year they turn 62. The net result is that replacement rates (based on 100 percent of PIA) measured against preretirement earnings are generally lower for those who retire after age 62 and by a greater amount than under the old law. It has been noted that the additional reduction in replacement rates resulting from indexing earnings' histories was about 2 percent (on average, when measured against all beneficiaries).[8]

Under the new law then, indexing the earnings' history means that an individual's replacement rate (and benefit) does not increase as significantly for additional years of work and retirement past age 62 as it would under the old law (see figure 3.2). In the 1977 Amendments, the delayed retirement credit was increased

[7] The Congress considered making the new law/transition provisions applicable to anyone, regardless of age of eligibility or birth year. As discussed in Myers, pp. 328–330, considerations were weighed as to whether to index the earnings' record to the time of retirement (filing initial claim) or to the earliest age of eligibility (usually age 62). Although the time of filing a claim initially was considered the more logical choice for determining the point of indexing the earnings' record, problems were anticipated. This would allow individuals, through selecting a retirement date, to select the indexing year as well. Results could differ depending on this filing date, and differences in information available to those nearing retirement might result in considerable variation in benefits among individuals. As a result, the time-of-eligibility approach was adopted for indexing. In addition, Myers notes that for administrative reasons and because of a time lag in obtaining data necessary in the indexing process, the *second year* prior to eligibility for benefits must be used—that is, age 60 for retiring workers. Any negative effect of this provision is largely offset by the use of slightly larger benefit percentage factors in the benefit formula.

[8] *Myers*, pp. 328–329.

from 1 to 3 percent for those retiring after age 65, who cannot use the old AMW method, to mitigate some of this effect.[9]



[a]Adjusted for actuarial reduction for retirement before age 65, but not delayed retirement credit thereafter

Source: SSA

Figure 3.2: Effect of Decoupling on Replacement Rates for an Average Earner After Age 62

On average under the new formula, replacement rates could be expected to be about 7 percent lower (including the 5-percent reduction embodied in the new formula benefit percentages and the 2 percent noted above). This difference was expected to vary between about 5 percent for those awarded benefits under survivor or disability provisions prior to age 62 or for retirement at age 62 and about 10 percent for those retiring at age 65 and over, compared with expected replacement rates in 1979 under the old law formula.[10] Thus, it could be said that a small notch was created by this intended lowering of replacement rates.

THE TRANSITION PROVISIONS

In the debate over decoupling and the consideration of legislation, implementation was an important concern. The Congress decided to make the new law/transition rules (but not the old rules)

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[9] A delayed retirement credit was applied to the benefits of those who retire after age 65. It was introduced because some felt that the earnings' test took away benefits from some without a concomitant increase for those who delayed receiving benefit past age 65. Note that the 1983 Amendments changed the rate to 8 percent in a phased-in procedure, beginning for those attaining age 65 in 1990 and reaching 8 percent in 2009 (for those attaining age 66, the "normal retirement age" at that time). See *Myers*, pp. 227–228.

[10] For more detailed discussion see *Myers*, pp. 328–330. Also see A. Haeworth Robertson, "Financial Status of Social Security Program After the Social Security Amendments of 1977," *Social Security Bulletin*, Vol. 41, No. 6, June 1978, pp. 22–24.

apply to those who attain eligibility age on a certain date. As the goal was to fix the benefit formula as quickly as possible, the effective date chosen for the new rules was January 1, 1979.[11] This decision created a sharp break, by date of birth, between those who would come under the new law and those who would continue to have their benefits computed using the pre-1977 rules. Legislative consideration of how the transition would be made from the old to the new formula focused on (1) the time period and retiree cohort to which the transition provisions would apply [12] and (2) a transitional benefit computation known as the "transitional guarantee."

To alleviate the drop in benefits for some that might occur under the new law, the 1977 Amendments introduced a new benefit computation called the "transitional guarantee." This was broadly intended to "guarantee" that benefits for those under the new law would not be lower than would have been received at age 62 (first eligibility for benefits) under the old law at the time of implementation of the Amendments. Based on the pre-1977 benefit formula, it applied to individuals receiving OASI benefits who attained age 62 in the period 1979–1983 (i.e., those born in the years 1917–1921). For those beneficiaries, benefits were calculated two ways, by the new-wage indexed formula and by the transitional guarantee formula. The higher of these two computations was paid as the actual benefit.

The transitional guarantee froze the old law benefit table in effect in December 1978 and the transitional group was "guaranteed" benefits no lower than would be calculated using it. However, this table was no longer adjusted for changes in prices for the transition group although it continued to be adjusted and used in computing benefits for those who attained age 62 prior to 1979 and came under the old law formula. Those in the transition group did not receive the benefit of CPI increases after 1978 and before their year of eligibility (age 62) under the transitional guarantee although, of course, they received such increases for the year of attaining age 62 and thereafter.

In addition, the benefit base computation was modified under the transition formula. In computing the AMW under the transitional guarantee, only earnings prior to the year of attaining the age of eligibility (age 62) were included. Those eligible for benefits prior to

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[11] The decision to apply the new law/transition provisions to those reaching eligibility age (age 62) after January 1, 1979, was not arbitrary, as is sometimes alleged. The alternative was to allow individuals to use the old rules (and/or new rules) as long as they filed for benefits by a certain date—irrespective, however, of their birth year/age of eligibility. The concern was that such provisions might induce many individuals to file for benefits at age 62 even though they were not actually retired in order to lock in the old law benefit formula (i.e., "rush to the rolls"). Another factor was that those with relatively few years of covered earnings might be able to file for benefits, lock in the old rules, then work several more years. They could then file for recomputation based on their additional work and, because they had locked in the old rules, receive a substantially higher benefit. This effect might even be present for some individuals who worked as little as a few additional days after filing for benefits. See U.S. Congress, House Committee on Ways and Means, Subcommittee on Social Security, *Hearings on Employer Payment of Social Security Taxes; Benefit Formula Differential*, 96th Congress, 1st Session, Sept. 27, 1979.

[12] The form of the transition provisions was debated throughout the approximately 2 years prior to adoption of the Amendments. Although a number of different transition provisions were proposed and discussed during this time, the provision that actually passed was essentially identical to that contained in the social security legislation introduced by the Ford Administration in the 94th Congress. See U.S. Congress, House, Committee on Ways and Means, Subcommittee on Social Security, *Hearings on Decoupling the Social Security Benefit Structure*, H.R. 14430, 94th Congress, 2nd Session, June 18, July 23 and 26, 1976, pp. 77–78.

1979 continued to have any earnings after age 61 included in the calculation of their AMW. Post-age 61 earnings for those in the transition group were included in benefit calculation only under the new wage-indexed formula.

Thus, the transitional guarantee was generally consistent with the goal of decoupling in that price changes did not affect the benefit formula. But the transitional guarantee also prevented earnings from being included for the segment of the transition group who worked past the age of 62. To some extent, this went beyond the goal of decoupling,[13] but was consistent with the goal of moving rapidly into the new benefit formula. The cost of extending the transition was a major concern of the Congress, which was trying to stabilize the system's financing and reduce costs in the short term.

LENGTH OF THE TRANSITION

Another aspect of the transition provisions concerned the size of the transition group or the number of age cohorts to which the transition provisions applied. In the early legislation proposed by the Ford Administration, in the legislation proposed by the Carter Administration, and in an amended bill passed by the House, a 10-year transition period was specified. Thus, the transitional guarantee formula would apply to those reaching age 62 in 1979–88. At the same time, the Senate passed an amended bill that included a 5-year transition period that would apply to those turning age 62 in the period 1979 through 1983. In the final conference that resulted in the 1977 Amendments, the House receded to the Senate provision and the 5-year transition was adopted.[14]

The length of the transition period was discussed in hearings on the Ford Administration bill, which proposed the 10-year transition. The following exchange between Congressman Archer and then Social Security Commissioner James B. Cardwell demonstrates some of the reasoning behind the transition provisions:

> Mr. ARCHER. I am interested in your proposal for a 10-year phase-in. Why not just have it take effect immediately? Why any phase-in at all?
>
> Commissioner CARDWELL. I think it is a good question. I guess our reaction to that question reflects our conditioning. We assume that under the tradition of this program that it is unfair to individuals to catch them on short notice. It turns out since you can't perfect a formula that works on averages, to guarantee automatically everybody will be treated as under present law, as the formula intends. We know that individuals could receive less under this formula than they would receive under existing law. We said the transition would avoid catching them off guard.The transition really says 10-years from now everybody must recognize that the new formula is fully effec-

[13] By this we mean that decoupling was intended to prevent inflation from directly affecting the benefit determination of future retirees. It was not intended to prevent wages from affecting the PIA as did the exclusion of post-age 61 earnings.

[14] House of Representatives, *Social Security Amendments of 1977, Conference Report to Accompany H.R.9346*, 95th Congress, 1st Session, Dec. 15, 1977, p. 67.

tive—it is kind of a 10-year notice. You could make the choice not to do it. We included it because it seemed to us it was fair, but that is a judgmental matter in many ways.

Mr. ARCHER. What cost factor are we looking at if we did it in a 10-year period as opposed to immediately?

Commissioner CARDWELL. You are talking about close to a billion dollars.

Mr. ARCHER. You say it would save close to a billion dollars if we put it into effect immediately rather than over a 10-year period?

Commissioner CARDWELL. Yes, through 1981. There would be additional savings in later years. A 5-year transition period would cost almost as much. As I indicated earlier, the long term cost of a 5-year period would be about 90–95 percent of the long term cost of the 10-year period.[15]

This excerpt indicates that a main purpose of the transition provisions was to "put people on notice" that a change in the benefit formula was in effect, avoiding a serious impact on those who were close to making retirement plans. The cost of a 5-year transition was not expected to be substantially different than the proposed 10-year transition. The transitional guarantee was, for the most part, expected to phase out, in terms of providing a higher benefit relative to the new wage-indexed computation, within 5-years. Extending the provisions to 10 years would have affected only a small percentage of beneficiaries.[16]

Thus, it was not the *length* of the transition period that mattered in terms of cost or effect on beneficiaries. Rather, it was the design of the transition formula and the benefit it would yield compared with the benefit under the new formula that would determine the effect of the transition provisions.

HOW THE TRANSITION WORKED

Generally, the transitional guarantee computation was intended to phase into the new wage-indexed formula. Initially, it could be expected to result in higher PIAs and benefit awards than under the new formula for some retired workers. Eventually, the benefit formula frozen as of December 1978, the exclusion of post-age 61 earnings, and absence of CPI increases after 1978 and before the age of eligibility were expected to result in less favorable benefit amounts, compared with the results of the new formula, thus reducing over time the proportion of newly retired workers helped by the guarantee. Thus, the new formula would provide the higher benefit for an increasing number of new retirees as the transition period wore on.

Subsequent to the adoption of the 1977 Amendments, the rate of inflation once again began to increase significantly more than expected. Those born before 1917 who attained eligibility age before 1979 thus remained under the old law formula and continued to re-

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[15] House of Representatives, Ways and Means Committee, *Hearings on Decoupling*, 1976.

[16] Estimates showed that fewer than 5 percent of those retiring in each year of year 6–10 of the transition period would have received a benefit computed under the transitional guarantee. House of Representatives, *Social Security Amendments of 1977, Report to Accompany H.R. 9346*, 95th Congress, 1st Session, Dec. 15, 1977, p. 29.

ceive the benefit of the overindexed formula. Under the transition provisions, more rapid inflation did not have a similar effect on the initial benefit. The new wage-indexed formula was not driven by price inflation before retirement, although higher wage growth could increase the benefit amounts. The transitional guarantee was essentially fixed, however, unaffected by price change, and additionally, beneficiaries could only include earnings up to age 62. Any earnings beyond age 62 were counted only under the new wage-indexed formula. In the context of higher-than-expected inflation, the design of the transition provisions meant that the new wage-indexed formula overtook the transitional guarantee formula, yielding a higher benefit for more retirees and more quickly. The transition phased out more abruptly than anticipated.

An SSA study calculated benefit levels using the hypothetical but representative steady earnings' histories for those in the transition group.[17] Comparing the benefit level under the new wage-indexed formula with that of the transitional guarantee, the study shows that the transitional guarantee yielded a higher benefit only to:

- those attaining age 62 in 1979,
- average and maximum earners attaining age 62 in 1980 and retiring at age 62, and
- maximum earners attaining age 62 in 1980 and retiring at age 63.

In almost all other cases, the new wage-indexed formula resulted in a higher benefit for those in the transition group. In the SSA study, data based on a sample of retirees reflecting actual earnings patterns, also shows that for those born in 1917 who retire at ages 62–65 and use either the wage-indexed or the transitional guarantee, half or more received higher benefits under the latter method. For those who attained age 62 in January 1980 (born 1918) and retired at age 62 or 63, less than half—but a significant portion—found the transitional guarantee yielded the higher benefit. But for those retiring at age 64 or 65, the percentage using the transitional guarantee dropped dramatically (to 15 and 9 percent respectively). For those in the 1919, 1920, and 1921 birth cohorts, only a small proportion (less than 10 percent) found that the transitional guarantee yielded a higher benefit than the new wage-indexed formula.

EFFECTS ON BENEFIT LEVELS

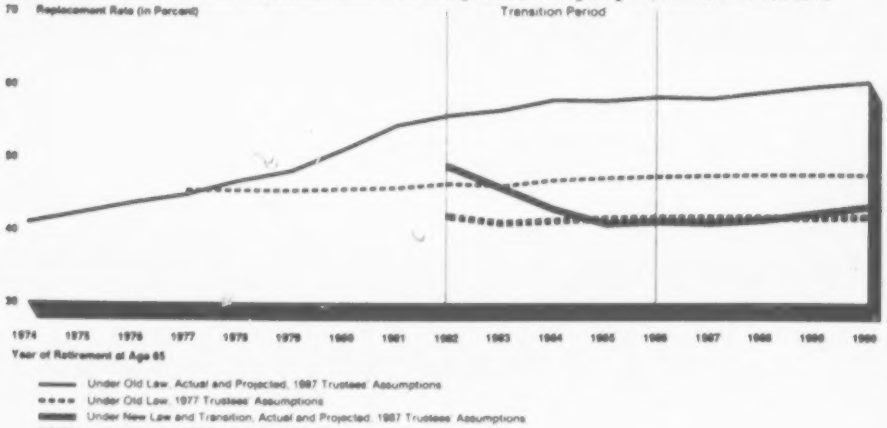
During the debate on the 1977 Amendments, it was generally anticipated that the phase-in would prevent a significant drop in the benefit levels of retirees in the transition period. Even so, it was well recognized that the goal of reducing replacement rates implied at least a relative reduction in the growth of benefit levels. What actually occurred, however, was that many in the transition group received a benefit that was *lower in dollar amount* compared with the group that retired just prior to the transition, whose benefits

[17] McKay and Schobel, pp. 9, 18.

were computed under the old law.[18] But this was not the result of transitional retiree's benefits being much lower than intended. Rather it occurred because beneficiaries under the old law received benefits that increased more rapidly than was anticipated when the 1977 Amendments were passed.[19]

Higher-than-anticipated growth of prices and wages resulted in higher replacement rates for those receiving benefits under the old law (see fig. 3.3). At the same time, while those under the new law/transition provisions saw the transitional guarantee phase out rapidly, new law replacement rates also rose more than expected. The notch that existed due to the 1977 Amendments became much greater. Inflationary conditions had raised everyone's benefits, but benefits under the old law rose relative to those under the new law.[20]

Figure 3.3: Anticipated and Actual Replacement Rates for an Average Earner Retiring at Age 65, Under Old and New Laws



Source: SSA

[18] This result may have been largely unforeseen as it is difficult to find evidence pointing to an awareness of the effect on the part of the Congress. This aspect is discussed in a recent study by the American Enterprise Institute (AEI), "Proposals to Deal With the Social Security Notch Problem," *Legislative Analyses*, Washington, D.C., 1985. The study notes that the Congress probably thought that, even though it was cutting benefit levels for those under the new law, the actual nominal benefit levels between cohorts would rise over time. This would be due to the normal pattern of rising wage levels, which generally resulted in rising benefit levels. If earnings (which affect the denominator of the replacement ratio) are rising over time and benefit levels are not rising or rising more slowly, a lowering of replacement rates can occur even though nominal benefit amounts are not lower.

[19] Not all individuals in the transition group found the transition rules disadvantageous compared with what they migh have received under the old law formula. This would largely depend on an individual's earnings' history. For example, if an individual had a history of high earnings early in his/her career with lower earnings toward the end, the new wage-indexed formula might yield a higher benefit award than the old law formula.

[20] This is not meant to imply that higher inflation alone was the cause of the notch. The disparities would have arisen regardless, due to the provisions of the new law. Our point is that higher inflation than anticipated made the disparities greater. An SSA actuary notes that "economic experience is actually a relatively small factor in the size of the notch." Furthermore he says, "While the actual notch numbers are larger than they would have been based on the 1977 Trustees' Report, the difference is not sufficient to suggest that the 'notch' would have been significantly less controversial if economic experience had been different." (Memorandum from Roy Ferguson, Actuary, SSA Office of the Actuary, "A Look Back at the Decoupling Estimates—Information," Aug. 26, 1986).

CHAPTER 4—MAGNITUDE AND DEFINITION OF BENEFIT DISPARITIES

That the transition rules were not working as expected was recognized shortly after the 1977 Amendments had been implemented. Hearings relating to the notch benefit disparity were held by the House Ways and Means Committee in September 1979. During the hearings, Social Security Administration officials explained the dimensions of the problem.[1] It was noted that a worker who turned age 62 in 1978 and continued to work until age 65 would, upon retirement, receive a somewhat higher benefit than a similar worker who turned 62 in 1979 (the first year of the transition) and continued to work until age 65. The officials further explained that the differential arose out of a set of conscious decisions on the part of the Congress in the 1977 Amendments. These decisions were that:

1. Benefits had been overindexed and produced higher amounts than desired. As a result, the Congress voted to reduce replacement rates.
2. Those who were nearing age 62 at the time should be entitled to benefits under the old law even though they were receiving slightly higher amounts than intended. But workers should begin to be converted to the new system as rapidly as possible. Thus, the date of January 1, 1979, was chosen for implementation of the transition provisions.

It was explained that a differential between adjacent cohorts of retirees (under old and new law) arose because, under the new system, benefits do not rise as rapidly after age 62 as a result of additional work. This is due to indexing of the earnings' record under the wage-indexed computation and exclusion of post-age 61 earnings under the transitional computation. One factor mitigating this effect was that the 1977 Amendments increased the credit for delayed retirement from 1 to 3 percent for persons attaining age 62 after 1978. However, this applied only to those delaying retirement past age 65.

Although the focus of the benefit formula revision and the reasons for the existence of a notch center on replacement rates, much of the public discussion of the notch relates to the size of benefit disparities between different cohorts of retirees. At the same time, the size of a benefit disparity can depend on the type of comparison made.

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[1] House of Representatives, Committee on Ways and Means, *Employer Payment of Social Security Taxes*, statement of Lawrence H. Thompson, Acting Associate Commissioner for Policy, SSA, pp. 10–14.

DATA ON BENEFIT DISPARITIES

In terms of benefit amounts, the most common way to define the notch is to compare the initial benefits of retirees in the transition group with the last cohort to receive benefits under the old formula. The initial monthly benefits of individuals who turned age 62 in January 1979, 1980, and 1981 are compared with those of an individual reaching age 62 in December of the previous year in table 4.1. The data, which are for average steady earners, illustrate the disparities associated with the notch. The December 1978 (born 1916) retiree is the only case in the table receiving benefits under the old benefit formula—all others are in the transition group.

Note the differences between the December and January retirees. Cases 1 and 2 compare an age 62 retiree born in December 1916 with an age 62 retiree born only a month later in January 1917. The difference in benefits is calculated in dollar amounts and as a percentage of the benefit of the older of the two adjacent retirees. For the age 62 retirees, the difference is about $6 per month. The differences get larger for later retirees in the 1917 cohort. At age 65, the difference is $88 per month or 14 percent less than a comparable 1916 cohort retiree. The difference for age 66–68 retirees is even higher, about 17 percent, as are the dollar amounts. Comparing the 1916 and 1917 cohorts in percentage terms, the benefit difference levels out after age 65. This is due largely to the effect of increasing the delayed retirement credit. Nevertheless, nominal dollar differences vary, and those in the $125 and above range underlie the concern over the effect of the transition provisions. Although in all cases the benefit rises for later retirement ages, the benefit of the individual under the old formula rises by a much greater amount than for the individual under the new law/transitional provisions.

Table 4.1.—Comparison of Initial Monthly Benefit for Persons Attaining Age 62 in Selected Months and Retiring at Various Times in Adjacent Months (1978–1981)

Case no.	Workers [b] characteristic	Monthly benefit [c] if retirement in January of						
		1979	1980	1981	1982	1983	1984	1985
	At age	62	63	64	65	66	67	68
	Attained age 62 in:							
1	Dec. 1978 (born 1916)	$313	$389	$500	$624	$716	$773	$834
2	Jan. 1979 (born 1917)	307	365	449	535	592	638	691
	Difference in benefit (2–1):							
	Dollars	–6	–24	–51	–88	–124	–135	–143
	Percent	–1.9	–6.2	–10.2	–14.1	–17.3	–17.5	–17.1
	At age	•	62	63	64	65	66	67
	Attained age 62 in:							
3	Dec. 1979 (born 1917)	[a]	$339	$420	$503	$576	$621	$674
4	Jan. 1980 (born 1918)	[a]	316	393	475	553	596	645
	Difference in benefit (4–3):							
	Dollars	[a]	–23	–27	–28	–23	–25	–29
	Percent	[a]	–6.8	–6.4	–5.6	–4.0	–4.0	–4.3
	At age	•	•	62	63	64	65	66
	Attained age 62 in:							
5	Dec. 1980 (born 1918)	[a]	[a]	$366	$444	$519	$581	$628
6	Jan. 1981 (born 1919)	[a]	[a]	344	416	485	542	585

Table 4.1.—Comparison of Initial Monthly Benefit for Persons Attaining Age 62 in Selected Months and Retiring at Various Times in Adjacent Months (1978–1981)—Continued

Case no.	Workers [b] characteristic	Monthly benefit [c] if retirement in January of						
		1979	1980	1981	1982	1983	1984	1985
	Difference in benefit (6–5):							
	Dollars	[a]	[a]	–22	–28	–34	–39	–43
	Percent	[a]	[a]	–6.0	–6.3	–6.6	–6.7	–6.1

[a] Not applicable.
[b] Average earner.
[c] Dollar amounts are rounded.
Source.—Computed by GAO using SSA's PIA computation software prepared by Steven F. McKay and John F. Dickstein, SSA, Office of the Actuary.

Data for the two other sets of retirees illustrate that there are also notches between adjacent cohorts *within* the transition group. That is, the individual turning a given retirement age in January compared to December has a smaller benefit. However, at later points in the transition group (i.e., those born 1918–1921), the differences in both dollar amount and in percentage terms are relatively much smaller. Differences are in the $20–30 range, which, although not inconsequential, vary only in the 4–6 percent range.

These "small notches" get even smaller for successive cohorts and by the end of the transition period, turn positive for the January retiree, a pattern consistent with the effect to be expected from rising wages over time. What the data imply is that the notch disparity is greatest and most clearly demonstrated by comparing the 1916 and 1917 cohorts, particularly those who retire at later ages. Furthermore, the notch effect is associated with benefits for the 1916 cohort rising faster than those of the 1917 cohort for later retirement ages.

The differences for the 1916 and 1917 cohorts by level of career earnings appear in table 4.2. The benefit awards display the following patterns:

1. The later an individual in the 1917 cohort retires, the greater tends to be the resulting disparity compared to the 1916 cohort.
2. The higher the level of a worker's lifetime earnings (earnings' history), the greater the disparity tends to be.

OTHER WAYS TO VIEW THE NOTCH

Defining the notch disparity as essentially a benefit disparity between the 1916 and 1917 cohorts is probably the most clear and valid representation of the notch. But there are other ways to look at the notch, and distinguishing between comparisons is important in any discussion of the notch issue. To a considerable extent, the size of the notch depends on the type of benefit comparison being made. One difficulty that arises is in comparing benefit levels across cohorts over a span of years. For example, comparison of the current dollar initial benefit (or PIA) of retirees in various years, at comparable ages, would show a generally rising pattern over time. Between January and December, the PIA for our typical individuals would rise (as a result of higher earnings generally). While the small notches mentioned above still are present between adja-

cent December and January retirees, the year-to-year differences in benefit awards between successive years of the transition group generally do not become greater. That is, if successive initial benefit awards (i.e., current-dollar PIA) of those retiring (at comparable ages) were compared with the previous cohort under the old law, the differences for these successive cohorts do not, in general, get larger (see fig. 4.1).

Table 4.2.—Comparison of Initial Monthly Benefits for Adjacent 1916 and 1917 Birth Cohorts by Earnings' Category

Retirement in January of (year), by earnings category [a]	Monthly benefit [b] for worker attaining age 62 in		Difference	
	December 1978 (old law)	January 1979 (new law)	Dollars	Percent
1979:				
Low earner	$207	$204	$-3	-1.4
Average earner	313	307	-6	-1.9
Maximum earner	396	389	-7	-1.8
1980:				
Low earner	254	242	-12	-4.7
Average earner	389	365	-24	-6.2
Maximum earner	494	463	-30	-6.1
1981:				
Low earner	325	298	-26	-8.0
Average earner	500	449	-51	-10.2
Maximum earner	636	570	-66	-10.4
1982:				
Low earner	400	355	-45	-11.3
Average earner	624	535	-88	-14.1
Maximum earner	790	679	-111	-14.1
1983:				
Low earner	449	392	-57	-12.7
Average earner	716	592	-124	-17.3
Maximum earner	901	755	-146	-16.2

[a] Low earner: Worker had earnings equal to 2,080 times the hourly Federal minimum wage in each year.
Average earner: Worker had earnings in each year equal to the annual average wage figure used for indexing earnings record.
Maximum earner: Worker had earnings equal to the maximum social security contributions and benefit base in each year.
Source.—Derived from information published in *SSA Program Circular-Public Information, No. 1244,* Oct. 1985.

One difficulty this comparison presents is that it is not generally appropriate to make nominal dollar comparisons of initial benefits across years, even if retirement age is held constant. For any given individual, benefit comparison with an earlier benefit ignores the fact that earlier retirees have received COLAs since retirement. Thus, comparison of benefit levels for individuals retiring at comparable ages in different years is more appropriately accomplished by presenting data in constant dollar terms.[2]

Such data on individual benefits payable in 1987 for those retiring at ages 62 and 65 from 1972–87 is presented in table 4.3. These can be considered as the current monthly benefit in January 1987 of those retiring at the given age in January of various years.[3]

[2] Application of COLAs to retiree PIAs tends to widen the disparities between old law and transition benefits.

[3] The benefits being compared are for January retirees. The earlier discussion compared the more closely adjacent December and January retirees. Thus, the "peak" benefit would be higher if a December 1978 benefit were calculated. However, while it is useful to compare December 1978 and January 1979 retirees, it is somewhat less appropriate to use the December benefit when comparing across a number of years.

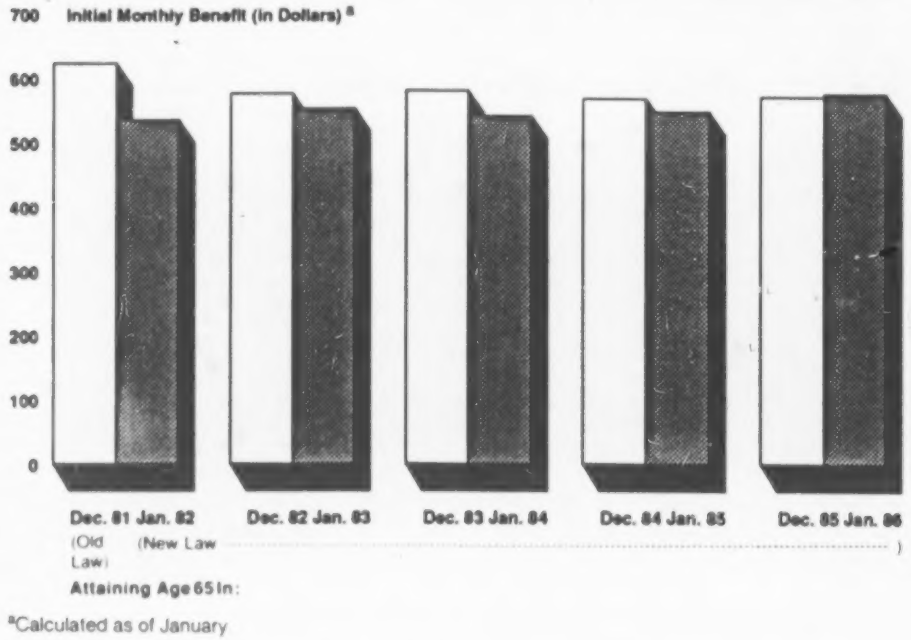

Figure 4.1: Initial Monthly Benefit of an Average Earner Retiring at Age 65 in Various Years and Adjacent Months

Generally, the initial PIA at retirement is adjusted for cost-of-living increases granted previous years' retirees, and this is compared with other retirees' monthly benefits as of January 1987. This table shows what retirees in various years now get in today's dollars.

Benefit levels peak in the first year of the transition for age 62 retirees and in the last pretransition year for age 65 retirees, as table 4.3 shows. For age 62 retirees, the last year under the old formula was 1978 and for age 65 retirees the year was 1981. The constant-dollar benefit levels for retirees under the old formula generally are higher than for those of comparable age retirees under the new benefit formula and transitional guarantee. Table 4.4 groups these data by birth year and age of retirement with the difference in benefits between the transition and peak years calculated. These differences display a pattern—the percentage benefit differences grow in successive years compared with the January 1978 benefit amount. However, by the end of the transition period the differences begin to narrow.[4] Also, the dollar differences tend to be greater in the age 65, average and maximum earnings' categories. For age 62 retirees, the percentage differences between the transition group benefit and that of the 1916 birth cohort under the old

[4] These differences will result in part from varying rates of wage growth for those yet to retire compared with the rate of price growth affecting the benefits of those already retired.

law vary in the +3.0 to -10.9 percent range. For age 65 retirees, the differences vary in the -7.6 to -19.6 percent range.

Table 4.3.—Monthly Benefits in 1987 of Workers Retiring in 1972–87 at Ages 62 and 65

Year in which benefits began	Monthly benefits,[a] by earnings level					
	At age 62[b]			At age 65		
	Low	Avg.	Max.	Low	Avg.	Max.
1972	$318	$459	$517	$386	$554	$627
1973	[c] 324	462	526	391	563	643
1974	323	474	543	395	576	663
1975	326	481	562	400	589	688
1976	326	485	580	409	609	733
1977	331	491	606	417	630	781
1978	333	504	633	430	655	822
1979	[d] 341	[d] 514	[d] 652	439	671	844
1980	[e] 323	[d] 482	[d] 615	453	688	873
1981	[c] 308	[e] 459	[e] 577	461	711	904
1982	[c] 308	[e] 449	[e] 570	[d] 426	[d] 643	[d] 816
1983	[c] 308	[e] 461	[e] 588	[e] 412	[e] 618	[e] 793
1984	[e] 312	[e] 469	[e] 604	[e] 390	[e] 586	[e] 760
1985	[e] 316	[e] 475	[e] 617	[c] 385	[e] 572	[e] 749
1986	[e] 324	[e] 488	[e] 638	[c] 385	[e] 593	[e] 769
1987 [f]	[e] 332	[e] 502	[e] 662	[e] 391	[e] 593	[e] 789

[a] In 1987 dollars.
[b] Adjusted for early retirement reduction.
[c] Based on special minimum computation.
[d] Based on transition guarantee computation.
[e] Based on new wage-indexed formula.
[f] Projected.
Source.—SSA

Table 4.4.—Monthly Benefits in 1987 of Workers Retiring at Ages 62 and 65 and Difference Compared With 1916 Cohort

Earnings' level	If retirement at age 62: monthly benefit[a] year of birth (and year of retirement[b])					
	1916 (1978)	1917 (1979)	1918 (1980)	1919 (1981)	1920 (1982)	1921 (1983)
Low	$333	$341	$323	$308	$308	$308
Difference	●	+8	-10	-25	-25	-25
(percent)	●	(+2.4)	(-3.0)	(-7.5)	(-7.5)	(-7.5)
Average	504	514	482	459	449	461
Difference	●	+10	-22	-45	-55	-43
(percent)	●	(+2.0)	(-4.7)	(-8.9)	(-10.9)	(-8.5)
Maximum	633	652	615	577	570	588
Difference	●	+19	-18	-56	-63	-45
(percent)	●	(+3.0)	(-2.8)	(-8.9)	(-10.0)	(-7.1)

Earnings' level	If retirement at age 65: monthly benefit[a] year of birth (and year of retirement[b])					
	1916 (1981)	1917 (1982)	1918 (1983)	1919 (1984)	1920 (1985)	1921 (1986)
Low	461	426	412	390	385	385
Difference	●	-35	-49	-71	-76	-76
(percent)	●	(-7.6)	(-10.6)	(-15.4)	(-16.5)	(-16.5)
Average	711	643	618	586	572	583
Difference	●	-68	-93	-125	-139	-128
(percent)	●	(-9.6)	(-13.1)	(-17.6)	(-19.6)	(-18.0)
Maximum	904	816	793	760	749	769
Difference	●	-88	-111	-144	-155	-135
(percent)	●	(-9.7)	(-12.3)	(-15.9)	(-17.2)	(-14.9)

[a] In 1987 dollars.
[b] Retirement in January of year.

DATA ON REPLACEMENT RATES

While benefit amounts are important in illustrating the benefit disparities arising from the 1977 Amendments, they are not the only way to view the notch and the impact it may have on beneficiaries. As discussed in chapter 3, most of the analysis and debate surrounding the pre-1977 benefit rules were conducted in terms of replacement rates. It is usually considered more appropriate to compare benefit levels across cohorts and years by means of the replacement rate. Replacement rate data for retirees at age 62 and age 65 are provided in table 4.5.[5]

Table 4.5.—Replacement Rates for Workers Retiring at Ages 62 and 65, by Earnings' Level

[In percent]

Year of retirement	Replacement rates for retirement, by earnings' level at					
	Age 62 [a]			Age 65		
	Low	Avg.	Max.	Low	Avg.	Max.
1965	38.5	30.6	32.1	40.0	31.4	32.9
1970	41.2	33.1	28.2	42.7	34.3	29.2
1971	45.9	35.1	31.5	47.5	36.6	32.8
1972	49.5	36.5	34.3	51.2	37.7	35.5
1973	[e] 61.3	38.3	34.6	[e] 61.3	39.2	35.5
1974	[e] 64.3	40.6	32.6	[e] 64.6	40.9	33.0
1975	[b] 59.5	[b] 42.3	[b] 30.1	59.5	42.3	30.1
1976	57.2	43.1	31.5	57.9	43.7	32.1
1977	56.6	43.6	32.4	57.2	44.8	33.5
1978	60.8	44.9	33.5	62.7	46.7	34.7
1979	[c] 58.6	[c] 46.1	[c] 34.9	60.4	48.1	36.1
1980	[d] 57.2	[c] 44.8	[c] 28.6	64.0	51.1	32.5
1981	[e] 57.3	[d] 43.9	[d] 26.7	68.5	54.4	33.4
1982	[e] 57.7	[d] 42.6	[d] 25.0	[c] 63.8	[c] 48.7	[c] 28.6
1983	[e] 59.6	[d] 42.7	[d] 24.4	[d] 63.7	[d] 45.8	[d] 26.4
1984	[d] 62.5	[d] 42.9	[d] 23.6	[d] 62.4	[d] 42.9	[d] 23.7
1985	[d] 65.4	[d] 42.5	[d] 23.5	[e] 63.8	[d] 40.9	[d] 22.8
1986	[d] 69.0	[d] 43.1	[d] 23.9	[e] 65.7	[d] 41.2	[d] 23.1
1987 [f]	72.0	43.4	23.7	67.5	41.0	22.6
1990 [f]	73.3	42.9	24.4	73.9	43.2	24.8
2000 [f]	70.1	42.7	26.3	68.9	41.3	25.4
2010 [f]	66.4–	42.7	28.1	65.1	41.3	27.1

[a] Based on 100 percent PIA.
[b] The projected replacement rates in the House Report on H.R. 9346 (1977 Amendments) were 55 percent for low earners, 43 percent for average earners, and 30 percent for maximum earners. The 1974 Advisory Council goal to stabilize replacement rates at current levels can be represented above by the 1975 (actual) level of replacement rates for age 62 retirees.
[c] Based on transitional guarantee computation.
[d] Based on new wage-indexed computation. For age 62, years 1979–1983 represent transition period for age 65, and 1982–1986 represent transition period.
[e] Based on special minimum computation.
[f] Projected.
Source.—Tables compiled by Orlo R. Nichols, Actuary, SSA, Apr. 7, 1987.

In 1975, the year of the Advisory Council report, replacement rates for ages 62 and 65 retirees were 59.5 percent for low earners, 42.3 percent for average earners, and 30.1 percent for maximum earners (see table 4.5). These rates generally continued their rise in

[5] The age 62 rates represent 100 percent of PIA, while, because of the reduction for early retirement, the actual benefit paid (and replacement rate) is approximately 20 percent lower. However, the rates given in the table are valid for relative comparison across cohorts.

the 1970s. In passing the 1977 legislation, the Congress decided that replacement rates would be lowered 5–10 percent from their projected 1979 levels, which were somewhat higher than 1975 levels. During the period immediately after passage of the 1977 Amendments, however, economic conditions resulted in a continued rise in replacement rates that peak for those retirees still under the old law.

In table 4.5, the transition period is indicated for each age and the general pattern is for rates to decline for successive cohorts during the transition period.

Data For Age 62 Retirees

Replacement rates did not fall as markedly for lower earners as for higher earners. For average earners, the replacement rate for age 62 retirees actually rose for the 1979 transition cohort and was about the same for the 1980 cohort as for the 1978 pretransition cohort. The replacement rates for average and low earners showed a rather moderate decline toward the "desired" level thereafter. For age 62 retirees, the rate for low earners rose after the transition.[6] The rate for maximum earners, however, declined steadily during the transition period.

Data For Age 65 Retirees

For age 65 retirees, the transition provisions did not take effect until the 1982 cohort. In the time between passage of the Amendments and implementation of the transition provisions, replacement rates steadily rose for low and average earners but not consistently for maximum earners. The last cohort under the old formula (1981) had a 68.5- and 54.4-percent replacement rate for low and average earners respectively. The maximum earner rate was 33.4 percent—about the same as that for the 1977 cohort.

During the transition period, replacement rates generally fell for average and maximum earner, age 65 retirees. Similar to age 62 retirees, the decline was less dramatic for low earners than for high earners.

From a pretransition peak of 54.4 percent, the 1982 cohort of average earners received a 48.7-percent replacement rate and the 1983 cohort, a 45.8-percent rate. Subsequently, the rate declined to the "desired level" (about 42 percent) for the 1984 cohort and thereafter. In addition, the rates for the low and average earner 1982 and 1983 cohorts were higher than the rates prevailing when the 1977 Amendments were passed.

INTENDED VS. ACTUAL REPLACEMENT RATES

In discussions of the notch, the question arises as to whether any cohort received lower benefit levels or replacement rates than anticipated. One way to explore this matter is to consider what the Congress actually passed regarding the new formula and transition provisions and what this implied for replacement rates at the time.

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[6] It should be noted that much of the rise in replacement rates in the low earnings' category is a result of the minimum wage not rising after 1981.

The replacement rates that could be expected from the 1977 Amendments, using the OASDI Annual Board of Trustees' Report assumptions at the time, are shown in table 4.6 for age 65 average earner retirees.

A replacement rate in the 46-47-percent range was expected for the last three age 65 retiree cohorts under the pre-1977 benefit formula. For the transition group, replacement rates were calculated to fall to the 41-42 percent range, even for the early transition cohorts. These data further suggest that, under the assumptions current at the time and given the actual provisions adopted, a fairly rapid transition could be expected.

Table 4.6.—Intended and Actual Replacement Rates for Workers Retiring At Age 65, by Year of Retirement (1979–2000)

[In percent]

Year of retirement at age 65	(1) "Intended" replacement rate based on 1977 Amendments	(2) Actual and projected replacement rates based on current law	(2–1) Difference in percentage points
		actual	
1979	46.7	48.1	+1.4
1980	46.6	51.1	+4.5
1981	47.0	54.4	+7.4
1982	41.9	48.7	+6.8
1983	41.0	45.8	+4.8
1984	41.3	42.9	+1.6
1985	41.6	40.9	-0.7
1986	•	41.2	•
		projected	
1987	•	41.0	•
1988	•	41.4	•
1989	•	42.3	•
1990	41.8	43.2	•
1995	41.8	42.8	•
2000	41.8	42.0	•

Source.—"Intended" replacement rates obtained from Robertson, p. 23. For similar data on age 62, see Ferguson. Actual and projected rates are based on Alternative II–B assumptions used in the 1987 Trustees' Report.
Note.—Calculations are for average earners.

While replacement rates for the transition group clearly were put on a path toward a lower stabilized level, the rate of inflation in the latter 1970s increased. This continued to fuel the benefit increases for those still having benefits computed under the old law formula. As a result, replacement rates continued to increase for this group. Since higher inflation fuels wage growth, higher-than-expected benefits for those under the new wage-indexed formula resulted, as well as for those who had not yet reached age 62 but who eventually would receive benefits under the transitional guarantee. Actual replacement rates are in general higher than those expected at the time the Amendments were adopted, as table 4.6 shows. Furthermore, replacement rates for the first 3 years of the transition period were higher than anticipated—*and* declined more gradually to the intended levels than the rates projected using the 1977 assumptions.

CHAPTER 5—ADDRESSING THE NOTCH ISSUE: POLICY ASPECTS, PROPOSALS, AND ALTERNATIVES

Public discussion and Congressional consideration of the notch issue has continued since shortly after the 1977 Amendments and new benefit formula went into effect. Despite at least 9 years of debate, the issue remains unresolved. In addition to its technical complexity, there are various perceptions of the notch and who is affected by it. Also, there are concerns about implementing legislation and the effects this could have on the financial status of the social security system.

EARLY CONSIDERATION OF THE NOTCH: THE HHS POSITION

Officials of the Department of Health and Human Services (HHS) testified concerning the notch issue in 1979.[1] The Department stated that, despite the apparent disparities in benefit amounts, the resulting benefit awards and replacement rates were the outcome of conscious decisions of the Congress. They recommended that the Congress not pass legislation aimed at alleviating the disparities. HHS officials did, however, discuss various options for addressing the notch issue:

1. Reduce the future benefits of those whose benefits are computed under the old law formula and who continue to work past age 62 by not including earnings for these years of work.
2. Increase the benefits of those whose benefits are computed under the new law (transition provisions) for those retiring in the first few years after the new law takes effect. This would reduce the differential by "equalizing up" benefits for those under the new law.
3. Employ a variation of (1) above. Those who turn 62 prior to 1979 would have their benefits computed under the old law but only including earnings up through 1978. Earnings after 1978 would be recomputed under a different provision and any increase resulting would be added to their old law benefit. Similarly, the transition retiree would get a benefit recomputation (to include post-age 61 earnings) figured under the new system and any increase would be added to the transition benefit.

While acknowledging that the effect of the 1977 legislation was to create the disparities in benefits, HHS noted that the proposed solutions would create significant problems in terms of both administrative implementation and cost to the system. For these reason, HHS did not recommend proposal 2 above, to raise benefits for

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[1] House of Representatives, *Hearings on Employer Payment of Social Security Taxes; Benefit Formula Differential.*

those under the new law. Proposal 1, to reduce benefits for those under the old law, would result in smaller benefit disparities but could mean some beneficiaries might not get a benefit increase for a number of years. The third option was a compromise: it would lower benefits for some under the old law and might raise benefits for some under the transition provisions. These two effects would largely offset each other in terms of cost to the system. HHS said this proposal would be difficult to implement, however, because of the considerable administrative complexity it would impose, requiring a large number of recomputations over many years.

The first and third options each would reduce the amount awarded in 1980 and subsequent years and involved recomputations using earnings in 1979 and subsequent years. Consequently, HHS noted that, if the Congress chose to make changes, the proposals should be enacted by December 31, 1979. HHS took the position, however, that the benefit disparities were not a "problem" but rather part of the solution enacted in the 1977 Amendments. During this period, no changes were enacted.

ROBERT J. MYERS' PROPOSAL

In subsequent discussion at the 1979 hearings, a variant of the HHS options was suggested by Robert J. Myers, former SSA Chief Actuary from 1947 to 1970.[2] His proposal applied to any retiree who reached age 62 before 1979—the pretransition group. Rather than continue use of the old benefit formula, the Myers proposal would apply to existing benefits a prospective increase based on how much the PIA, calculated under the new formula and including post-1978 earnings, increased compared with the PIA computed excluding post-1978 earnings. This meant that the benefit increases for those under the old formula (based on post-1978 earnings) would be based on the new law benefit formula (AIME method) and the amount those earnings would increase the new law benefit as opposed to the old law benefit.[3]

The major advantage of his proposal, Myers maintained, was that it would lessen the notch disparity by reducing only future benefit increases, not any benefit levels already received. The Myers proposal also would preserve the intent of the new benefit provisions—a desirable feature. Furthermore, unlike HHS's options, it did not have to be enacted in 1979. Implementation could be delayed for about a year, which also would have given the Congress more time to consider it. Myers notes that enactment of his proposal by the middle of 1981 would have done much to alleviate the notch disparities, because it could have been applicable to 1980 earnings.

In March 1981, the National Commission on Social Security issued a comprehensive report making numerous recommendations concerning social security.[4] The Commission recommended that

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[2] Myers, pp. 174-177.

[3] Myers' proposal would have made the delayed retirement credit equal to 3 percent for all persons and all periods after 1981, as opposed to current law, which was 1 percent for those attaining age 65 before 1982 and 3 percent for later attainments. See Myers, pp. 175-176.

[4] National Commission on Social Security, *Social Security in America's Future*, Washington, D.C., Mar. 1981, p. 323.

the Congress address the "notch problem." At about the same time, the newly elected Reagan Administration was making its early proposals on social security. Included in its package of proposals was the Myers' proposal to address the notch. However, in part because this package of proposals was, in general, not received favorably by the Congress, no changes regarding the notch were enacted during this time.[5]

THE NOTCH ISSUE ALMOST DISAPPEARS

In the 1981–1983 period, the social security system was a focus of Congressional debate.[6] The declines in employment and earnings associated with economic recession in 1981–83 reduced revenues to the trust funds and worsened the system's short-run financing outlook. The short-run financing problems occurred in the context of a long-run actuarial deficit, which had not been completely addressed in the 1977 Amendments. President Reagan appointed another national commission, headed by economist Alan Greenspan, to devise a bipartisan solution to the system's financial difficulty. In this environment, the notch issue received little attention.[7] There may have been reluctance to address the issue because some of the options for addressing the notch carried substantial costs. Also, because the issue was not addressed before the end of 1981, the administrative difficulties in recomputing benefits became greater and potentially more costly.

The notch issue might have disappeared, since experts maintained that the time had passed for a feasible solution, and the Congress had just gone through the wrenching process of passing the 1983 Amendments to avert a financial crisis.[8] In late 1983, however, a series of columns by the well-known newspaper feature writer Abigail Van Buren called attention once again to the matter.[9] The "Dear Abby," columns turned what was a complex technical issue, known to a relatively small number of experts, into an immediate concern of millions of benefit recipients. Subsequent to the "Dear Abby" column, several members of the Congress moved to renew the debate by introducing new legislation to address the notch issue. It was at this point that the development of the issue took a major turn and became one of greater controversy. Because the matter was highly technical, some of the information provided in the "Dear Abby" column was found to be misleading and likely created some mistaken impressions about the notch and who was affected by it.

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[5] Myers, p. 332.

[6] For one account of the events of this period, see Paul Light, *Artful Work: The Politics of Social Security Reform* (New York: Random House, 1985).

[7] *Report of the National Commission on Social Security Reform*, Jan. 1983. There is no apparent reference in this report to the notch situation nor any consideration of it.

[8] Our review of bills introduced in the 97th Congress (1981–1982) relating to social security did not find any that specifically concerned the notch, although elsewhere we found a reference to H.R. 5469 in the 97th Congress. The American Enterprise Institute study mentioned in ch. 3 notes that 21 bills and resolutions relating to the notch were introduced in the 98th Congress (1983–1984).

[9] *The Washington Times Magazine*, Sept. 5, 1983, p. 15D, also Nov. 14, 1983, p. 15D. See related materials compiled in an Information Package by the Congressional Research Service, Library of Congress, *The Social Security Notch*, IP0266S.

"DEAR ABBY" AND OTHER VIEWS OF THE NOTCH

The original "Dear Abby" column asserted that those in the transition group (born 1917–1921) were disadvantaged both relative to those born earlier *and* relative to those born later who were not in the transition group. As chapter 4 shows, those who received benefits under the new law/transition guarantee generally received lower benefits than those in the last few cohorts under the old law. However, it is not the case that those in the transition group always receive lower benefits than those who follow the transition group (those born after 1921), in part because the transition group has its benefit computed two ways—new law and transition guarantee—and receives the higher of the two benefits.

Another "Dear Abby" column implied that the new law arbitrarily discriminated against those born after 1916 and in favor of those born before 1917. While the existence of differences in benefits appears to support this contention, it is misleading to create the impression that those born after 1916 are discriminated against. The choice of a date for implementation of the new law may appear arbitrary, but there was valid reasoning behind the choice of implementation date, as discussed in chapter 3.[10]

Moreover, the charge of discrimination against a particular group is misleading insofar as those in the transition group compare themselves to only the nearest cohorts that benefited (and benefited disproportionately) from the overindexed formula. Figure 5.1 illustrates this point from the data on replacement rates we presented in chapter 4. The "peak" replacement rates, for age 65 retirees occurred in the 1980–81 period. The replacement rates for the transition group decline steadily (and rapidly) to a stabilized level around the 42–43 percent intended by the 1977 legislation. Stable replacement rates are projected for those retirees under the new law benefit formula.

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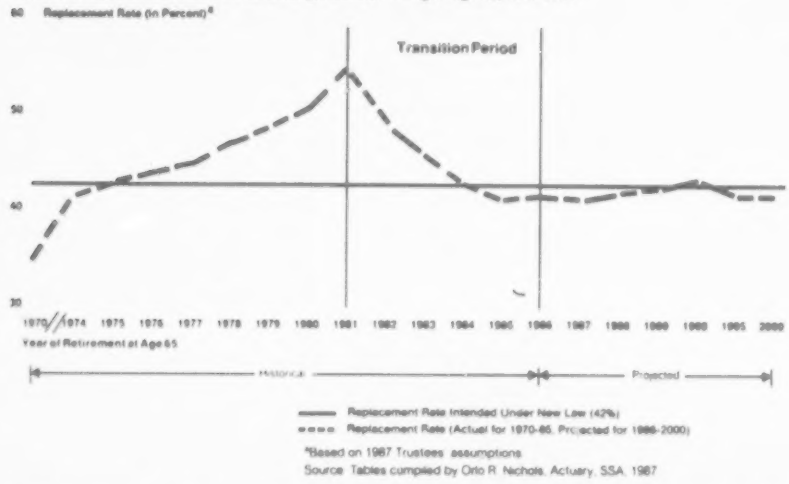
[10] See discussion in ch. 3, footnote 11. Also note that the impression developed that *all* individuals in the transition group received lower benefits than the benefit based on the old formula. As the discussion in ch. 3, footnote 20 suggests, this is not true. Also, as ch. 4 shows, there is little difference in benefit amounts between the 1916 (old law) cohort and transition cohorts for those retiring at age 62.

Figure 5.1: Replacement Rates for an Average Earner Retiring at Age 65, 1970-2000



*Based on 1987 Trustees assumptions
Source: Tables compiled by Orlo R. Nichols, Actuary, SSA, 1987

If the transition group is compared with those coming before and after, we find again (as we did in ch. 4) that most in the transition group received a higher replacement rate than did many of those born earlier and later than the transition group. In fact, when compared with the "intended" replacement rate of the 1977 Amendments, those who received higher benefits in relation to earnings span the period of retirement at age 65 from 1974 to 1985 (i.e., those born 1909–20). It is perhaps more appropriate to describe the notch as really only a part of a larger "mountain" of higher-than-intended replacement rates. At the peak of the mountain are some who are in the pretransition group and some who are in the transition or notch group.

Another view is that the benefits of those in the transition group should be compared to what they would have received had the old benefit formula never been changed. There are references in the public debate to the notch (or more specifically the size of the notch) being determined by the difference between the new law/transitional guarantee benefits and the benefits individuals would have received had they come under the old law provisions. This definition goes beyond comparison with the benefits of the last pretransition cohort to suggest an "entitlement" to benefits under the old law. The major goal of the benefit formula revision was to correct a problem that resulted in some recipients being compensated at an unexpectedly high level. It seems incorrect to suggest that beneficiaries are entitled to a benefit based on an old formula that has been changed as well as to characterize such a comparison as the notch problem.

In summary, the effect of the "Dear Abby" columns was to trigger a broader, more political debate regarding the technical notch problem. The public exchanges served to inform millions of people about a problem that might affect their daily lives and incomes. At the same time, the attempt to simplify a highly technical issue created some mistaken and misleading impressions among affected in-

dividuals and some who thought that they were seriously affected. A "perception" issue arose—individuals felt that they were not being dealt with fairly. It has been noted that this could lead to diminished faith in the social security system.[11]

LEGISLATIVE ATTEMPTS TO ADDRESS THE NOTCH ISSUE

Following the attempts of the early 1980s to address the notch issue, the renewed public interest in it generated increased attempts to legislate a solution. The AEI legislative analysis classifies legislative proposals as those that would:

- raise benefits by lengthening the transition to the new system,
- restore the pre-1977 benefit rules, or
- study the notch issue.

None of the proposed legislation to deal with the notch issue has been enacted to date, and because of the large number of bills introduced over time, we will not attempt to discuss them all.[12] The major focus of attention in recent years has been H.R. 1917 (and its' predecessor), introduced by Representative Edward Roybal, Chairman of the House Select Committee on Aging (with numerous cosponsors) in each of the last three Congresses. The form of H.R. 1917 has changed over time, from its introduction in the 98th Congress as H.R. 4093 to its current version in the 100th Congress, introduced April 2, 1987. The earlier versions proposed to extend the transition period to the new wage-indexed benefit formula as well as liberalize benefits computed under the transition formula but did not seek to completely restore the pre-1977 benefit computation rules. Major elements of the early version of H.R. 1917 were as follows:

- Lengthen the transition period by making the transitional guarantee available to those who attain age 62 after 1983 (the current cut-off for the transition group). Also, this provision would be restricted to those with at least 27 quarters of coverage before 1979.
- Allow earnings after the year of attaining age 61 to be used in the benefit computation. This provision would be restricted to include only 3 years of earnings after 1978 up to a maximum of $29,700 per year.
- Revise the transitional guarantee, specifically the 1978 frozen benefit table, to include benefit increases (COLAs) occurring after 1978.
- Limit the number of computation years to 25 under the transitional guarantee method rather than continue the increase under present law to 35 years for workers attaining age 62 in 1991 or later.
- Make changes retroactive, paid in a lump sum, and not applicable to dependents.

While not going so far as to restore completely the pre-1977 benefit rules, this proposal would have gone a long way toward such restoration while lengthening the transition period to perhaps 20–

[11] For an identification of this problem see AEI, "Proposals...," pp. 20–21.
[12] For a review of earlier legislation, see AEI, "Proposals...".

30 years. In moving back toward the earlier overindexed benefit formula and extending the transition to many benefit recipients not in the original transition, the bill essentially constituted a proposal for a general benefit increase for a large group of current and future benefit recipients.

The main criticism levied against the original version of H.R. 1917 was that it would be very costly to the Social Security Trust Funds. Over the past several years, SSA has made various estimates of the cost of the bill, ranging from $77.8 to $92.6 billion through 1990, including retroactive payments to beneficiaries. Most recently SSA, using a more recent beneficiary sample and improved estimation methods, projected the cost of the original version of H.R. 1917 to be $242.9 billion over the period 1987–1995.[13]

Near the end of the 99th Congress (fall 1986), there was discussion of revising the bill, in large part aimed at reducing its cost. A 10-year transition period, similar to that proposed in the debate leading to the 1977 Amendments, was discussed. During the current 100th Congress, Representative Roybal and his cosponsors introduced a new version of H.R. 1917, whose key features are (1) a 10-year transition period and (2) computation of benefits under the pre-1977 formula, except that they are reduced by 3 percent plus an additional 3 percent for each year of birth after 1916. Thus, an individual born in 1917 would get the old law benefit less 6 percent, one born in 1918 would get 9 percent less, one born in 1919 12 percent less, and so on (see table 5.1).

Essentially, the bill prescribes an alternative transition formula that would be retroactive for the transition cohort. The formula is based on a computation of benefits under the old law, from which a fixed percentage would be deducted. The bill would require much lower disbursements compared to the more recent SSA estimate of the earlier H.R. 1917 introduced in the 99th Congress, but the cost would remain significant. SSA estimates the cost of this bill over the period 1987–1996 at about $86.4 billion.[14]

Table 5.1.—Reduction of Social Security Benefit Based on Pre-1977 Formula Proposed in H.R. 1917, 100th Congress

Year of birth	Percentage reduction in old law benefit
1917	6
1918	9
1919	12
1920	15
1921	18
1922	21
1923	24
1924	27
1925	30
1926	33

[13] Cost estimates are contained in various memoranda prepared by SSA's Office of the Actuary. The revised estimate of the earlier version of H.R. 1917 is contained in a memorandum prepared by Roy A. Ferguson and John F. Dickstein, Actuaries, in SSA, "Estimated Short Range Financial Effects of Two Proposals to Increase Benefits for Certain Workers Who Attain Age 62 After 1978—Information," Mar. 11, 1987.

[14] Memorandum by Roy A. Ferguson, June 23, 1987.

OTHER LEGISLATION IN THE 100TH CONGRESS

A number of other bills and resolutions to address the notch disparity have been introduced in the 100th Congress.[15] One proposal of interest is contained in H.R. 1721 (previously introduced as H.R. 121) sponsored by Representative Hal Daub. Like H.R. 1917, this bill proposes an alternative transition formula. However, it differs from H.R. 1917 in important respects. First, the transition period is not extended beyond the original 5-year period. Second, the actual transition formula proposed is based on the new law formula plus a declining percentage of the *difference* between the benefit computed under the old law (including 3 more years of earnings after the year of attaining age 61) and the benefit under the new law. The formula, which could be called a "blended" formula, is shown in table 5.2.

Table 5.2.—Transitional Benefit Formula Under H.R. 121/1721

Worker reaching age 62 in	Would be guaranteed a PIA of no less than
1979	New law PIA + 60% (modified old law PIA–AIME PIA)
1980	New law PIA + 35% (modified old law PIA–AIME PIA)
1981	New law PIA + 30% (modified old law PIA–AIME PIA)
1982	New law PIA + 25% (modified old law PIA–AIME PIA)
1983	New law PIA + 10% (modified old law PIA–AIME PIA)

Essentially, the formula would give transition retirees the new law benefit plus an additional amount related to the old formula with the percentage declining through each year of the transition period. The bill is estimated by SSA to cost $24.3 billion from 1988–96.

Another proposal for addressing the notch in the 100th Congress is contained in S.1830, introduced by Senator Terry Sanford in November 1987. The same proposal was introduced in a House bill, H.R. 3788, by Representative Harold Ford in December 1987. The Sanford/Ford bills' major provisions are:

- Extend the transition period an additional 8 years. While the current transition period covers those born 1917–21, this proposal would include in the transition group those born 1917–1929.
- Compute benefits for the transition group three ways: through the wage-indexed formula, the current law transitional guarantee, and a new transition provision. Beneficiaries would receive the highest of the three computed benefits.

[15] As of Mar. 1988, our review shows at least 3 resolutions and 17 bills introduced in the 100th Congress. See app. IV and V for a listing as well as the cost of several bills as estimated by SSA. Among the various measures for addressing the notch issue, the AEI study (pp. 16–18) mentions several that either have not been introduced in legislation or only in relation to other provisions. Among these measures are:

- Count earnings after the year of attaining age 61 in the transitional guarantee computation.
- Count certain benefit increases that would be currently excluded in the transitional guarantee computation.
- Freeze social security benefits (or COLAs) for certain recipients who reaped the largest windfalls.
- Refund a portion of social security taxes to those who were unable to count earnings after the year of attaining age 61 in the transitional guarantee.

- Base the new transition provision on pre-1977 law. It would include all COLAs, but limit maximum annual creditable earnings after 1981 to $29,700 and exclude earnings in years after the year the worker reaches age 65. A factor then would be applied to the modified old law benefit, reducing it by 5 percent, plus 2 percent for each year of birth after 1916. The factor also would be reduced by one-twelfth of 1 percent for each month that entitlement was delayed after age 62 and before the month of attaining age 65.
- Make benefits retroactive but limited to a total of $1,000 per family.
- Do not use, for workers born *before* 1917, earnings for years after attaining age 70 to compute or recompute benefits for January 1986 or later, although existing benefits would not be reduced.

SSA estimates the 10-year cost of the Sanford/Ford bill to be $67.5 billion. This cost is higher than the cost of the H.R. 121/1721 and closer to, but lower than, the cost of H.R. 1917.

CHAPTER 6—EFFECTS OF PROPOSED LEGISLATION ON SOCIAL SECURITY'S FINANCIAL STATUS

The potentially significant cost of legislative proposals addressing the notch issue has been a major deterrent to their passage. This does not mean that cost should be the primary factor in determining whether a legislative "solution" is warranted. However, assuming that a solution is warranted, the cost and method of financing become an integral part of determining feasibility. Much consideration has been given to how proposed legislation and other solutions would affect social security's finances in both the short and long run. Several little-recognized concerns related to the method of financing notch solutions are who really "pays" for them and who benefits. These concerns are the focus of this and the next chapter.

CURRENT STATUS OF THE TRUST FUNDS

Since implementation of the 1983 Amendments to the Social Security Act, the financial status of the OASDI Trust Funds is much improved. Underlying this improvement have been positive economic conditions. Wage growth has been moderate, while inflation has been low relative to current wage growth and the inflation rates of the 1970s and early 1980s. National income has grown through this period, as has aggregate employment. As a result, the short-run status of the trust funds has steadily improved, to some degree more than expected. Under SSA's intermediate economic assumptions (alternative II-B), at the end of 1986 the funds totaled $46.9 billion and at the beginning of 1987 (including advance transfers to pay January benefits), the funds were at $65.2 billion (see table 6.1). The contingency trust fund ratio [1] in January 1987 was 31 percent; i.e., the balance in the funds could cover about 4 months' disbursements. Given the economic and demographic assumptions and legislated payroll tax increases in 1988 and 1990, the funds are projected to increase in the future. During the current 5-year horizon of the short-range estimates, the funds will grow substantially, reaching a projected balance of $260.5 billion at the end of 1991. In January 1991, a contingency fund ratio of 83 percent, close to what can be considered an adequate contingency level, is expected.

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[1] The measure known as the trust fund ratio relates the balance in the relevant trust fund (usually as of the beginning of the year) to the projected annual disbursements from that trust fund. It measures the percentage of assets on hand to cover expected annual disbursements. It is also expressed in number of months and is used as a measure of the system's short-run condition.

Table 6.1.—Projected Status Of OASI And DI Trust Funds, Combined, By Alternative (1986–91)

[Figures in billions]

Calendar year/alternative	Estimated status of OASI and DI Trust Funds, combined					
	Income	Disbursements	Net increase in funds	Funds at end of year	Contingency fund	
					Amount [a]	Ratio (percent) [b]
Actual:						
1986	$216.8	$201.5	$4.7	$46.9	$58.5	29
Projected:						
Alternative I (optimistic):						
1987	232.2	209.2	23.0	69.9	65.2	31
1988	265.8	220.5	45.4	115.2	92.1	42
1989	288.4	232.2	56.2	171.5	139.4	60
1990	317.6	245.4	72.2	243.7	197.8	81
1991	341.3	257.8	83.5	327.2	271.7	105
Alternative II–B (intermediate):						
1987	229.8	209.7	20.2	67.0	65.2	31
1988	259.4	222.6	36.8	103.9	88.7	40
1989	279.5	238.1	41.4	145.2	127.3	53
1990	309.4	255.1	54.4	199.6	170.8	67
1991	334.2	273.2	60.9	260.5	227.0	83
Alternative III (pessimistic):						
1987	225.0	210.4	14.6	61.5	65.2	31
1988	246.7	224.3	22.3	83.8	82.0	37
1989	266.0	242.9	23.1	06.9	106.4	44
1990	287.6	264.9	22.7	129.6	130.9	49
1991	310.5	286.9	23.6	153.2	155.3	54

[a] Represents assets at beginning of year, plus advance tax transfers for January.
[b] Represents assets at beginning of year, plus advance tax transfers, as a percentage of outgo during the year.
Source.—*1987 Annual Report of the Board of Trustees* (Washington, D.C. OASDI, Mar. 31, 1987), p. 45, table 15.

SSA provides estimates on the basis of optimistic (alternative I), intermediate (alternative II-B), and pessimistic (alternative III) assumptions about future economic and demographic conditions. While better-than-expected economic conditions are possible, the economy is well into the current period of economic recovery that began in December 1982. Thus, in evaluating the effects of legislation, it is important in the current economic environment to supplement consideration of the intermediate projections by reviewing SSA's pessimistic projections.[2] These allow for the possibility of recession over the 5-year projection horizon.

The pessimistic projections imply lower wage growth relative to slightly higher inflation (slower real wage growth [3]), higher interest rates, and higher unemployment during 1987–1990. Compared with alternative II-B, as table 6.1 shows, the pessimistic alternative III estimates lower income and higher disbursements for the trust funds. At the end of 1991, the trust fund balance would be $153.2 billion. In January 1991 under pessimistic assumptions, the trust fund ratio would be 54 percent. Such a level translates into about 6 months' disbursements, which is a relatively low short-run contingency level.

LONG-RANGE ACTUARIAL STATUS OF THE TRUST FUNDS

An important measure of social security's long-range financial status is the 75-year actuarial balance. Actuarial balance is the relationship between the 75-year averages of annual expenditures and revenues (projected) as a percentage of taxable payroll, using the Board of Trustees' assumptions concerning future economic and demographic trends. When the cost rate (the average expenditure percentage) equals the income rate (the average revenue percentage) over 75 years, the system is considered to be in actuarial balance. When the cost rate exceeds the income rate, the system is in actuarial deficit, and the 75-year average difference represents the amount by which the payroll tax rate would have to be raised to bring the system into long-run actuarial balance. When the income rate exceeds the cost rate over the 75-year period, the system is considered to be in actuarial surplus. The system is considered in *close actuarial balance* when the 75-year income rate is within a range of 95 to 105 percent of the cost rate.

In March 1987, the Board of Trustees' projections (under the intermediate II-B assumptions) showed a small 75-year actuarial deficit for OASDI, -.62 percent of taxable payroll. The projected income rate (12.89) is just within 95 percent of the projected cost rate (13.51), which makes the system, although in deficit, within close actuarial balance.

Assuming no change in current law, two important factors will determine whether the system maintains close actuarial balance in the near future:

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[2] As of Mar. 1988, the economy was in the 63rd month of recovery. This is the second longest recovery in the postwar period. The average length of postwar recoveries is about 56 months.

[3] Real wage change is the difference between the percentage change in nominal covered wages and the percentage change in the price level (the CPI).

1. Changes in the underlying economic and demographic assumptions that are less favorable, would result in a larger actuarial deficit.
2. Projected demographic conditions could cause a tendency toward larger actuarial deficits over time.

From now until around the year 2015, projected demographic conditions are favorable to the system and would tend to result in years when the income rate exceeds the cost rate. But as the year 2015 approaches, the "Baby Boom" generation will be retiring. This will result in generally unfavorable demographic conditions for the system, making each year after about 2020 one of actuarial deficit. Thus, for each future year, the 75-year projection period will "lose" a year of actuarial surplus and "add" a future year of actuarial deficit. Other things being equal, the 75-year projections, tending toward larger actuarial deficits over time, could very shortly show the system out of close actuarial balance.

EFFECT OF NOTCH LEGISLATION ON THE TRUST FUNDS

The cost of legislation relating to the notch issue and its effect on the trust funds depends, of course, on the final form of any legislation. Two bills that we reviewed, H.R. 1917 and Representative Daub's bill, H.R. 121/1721, would result in increased benefits, associated administrative costs, and foregone interest to the trust funds according to SSA estimates (see table 6.2). The effect on the trust funds is a primary consideration, as no proposed bills provide for financing notch legislation other than by using current and projected revenues to the trust funds.

If enacted, these two bills could have a sizable impact on the trust fund balances. Over the 10-year period 1987–96, H.R. 1917 would cost the trust funds $86.4 billion and H.R. 121/1721, $24.3 billion, the estimates show. As notch legislation would increase expenditures from the trust funds, it would result in lower trust fund ratios. The alternative II–B estimates in table 6.2 show that, under present law, the OASDI funds would achieve a trust fund ratio of 100 percent or 1 year's reserve by 1992 and reach 169 percent of annual disbursements or about 20 months' reserve by 1996.

Table 6.2.—Effect of Proposed Notch Legislation on the OASDI Trust Funds (1987–1995)

[Figures (except trust fund ratio) in billions of dollars; based on SSA estimates and alternative II–B economic assumptions]

Calendar year	Projected status of OASDI Trust Funds (no notch legislation)					
	Excluding interest	Interest income	Total	Outgo	Balance, end of year	Trust fund ratio (percent) [a]
1986	●	●	$216.8	$201.5	$46.9	29
1987	$224.6	$5.2	229.8	209.7	67.0	31
1988	252.2	7.3	259.4	222.6	103.9	40
1989	269.1	10.3	279.5	238.1	145.2	53
1990	295.3	14.2	309.4	255.1	199.6	67
1991	315.6	18.6	334.2	273.2	260.5	83
1992	337.5	23.2	360.7	291.1	330.2	100
1993	359.7	28.0	387.6	309.5	408.4	117
1994	382.8	33.0	415.7	328.9	495.2	134
1995	407.0	38.4	445.4	349.4	591.2	152

Table 6.2.—Effect of Proposed Notch Legislation on the OASDI Trust Funds (1987–1995)—Continued

[Figures (except trust fund ratio) in billions of dollars; based on SSA estimates and alternative II–B economic assumptions]

Calendar year	Projected status of OASDI Trust Funds (no notch legislation)					
	Excluding interest	Interest income	Total	Outgo	Balance, end of year	Trust fund ratio (percent) [a]
1996	433.2	44.1	477.3	371.1	697.3	169

	Projected status of OASDI Trust Funds (notch legislation)							
	H.R. 1917				H.R. 121/1721			
	Cost	Outgo	Balance, end of year	Trust fund ratio (percent) [a]	Cost	Outgo	Balance, end of year	Trust fund ratio percent) [a]
1987	$15.5	$225.2	$51.6	29	●	$209.7	$67.0	31
1988	5.6	228.3	81.3	32	$2.2	224.9	101.5	39
1989	6.5	244.6	114.1	43	2.6	240.7	140.0	52
1990	7.3	262.4	158.5	53	2.7	257.8	191.2	64
1991	7.9	281.1	208.1	66	2.8	275.9	248.7	79
1992	8.3	299.4	265.1	79	2.8	293.8	314.7	95
1993	8.5	318.0	329.6	93	2.8	312.2	388.9	111
1994	8.7	337.6	401.7	107	2.8	331.6	471.6	127
1995	8.9	358.3	481.9	122	2.8	352.0	563.2	144
1996	9.0	380.1	571.2	137	2.8	373.7	664.7	161
Total cost, 1987–96	**$86.4**				**$24.3**			

[a] Assets at beginning of year as a percentage of outgo during year.

While there is no official definition of an adequate contingency level for the trust funds, a trust fund ratio of 100 percent (or 1 year's reserve) generally is considered adequate. A study by Munnell and Blais notes that a trust fund reserve ratio of between 85 and 145 percent is sufficient to weather a period of poor economic conditions similar to those experienced in 1973–80.[4] Under this definition, the funds do not exceed the upper boundary of this range until 1995 under alternative II–B assumptions. The cost of H.R. 1917 prevents the funds from exceeding the Munnell-Blais contingency reserve range during the 10-year projection horizon, as table 6.2 shows. H.R. 121/1721, while also costly, would have a much less serious impact on the funds and the trust fund ratio. In 1996, H.R. 121/1721 would produce a trust fund ratio of 161 compared with 169 under current projections, it is estimated.

While the cost of notch legislation may not appear as significant in relation to the large projected trust fund balances, it should be recognized that over the next 10 years the funds are projected to attain only minimum contingency reserve levels. At that time, the funds would only reach the point at which the much-discussed "surplus" reserves would begin to accumulate. Therefore, notch legislation would slow the system's attainment of minimum contingency reserve levels. More importantly, notch legislation could put the system at additional risk should the economy experience a downturn.

[4] Alicia Munnell and Lynn Blais, "Do We Want Large Social Security Surpluses?" *New England Economic Review*, Sept./Oct. 1984, pp. 5–21.

In terms of long-run actuarial status, additional costs arising from notch legislation (without alternative financing mechanisms) would worsen the system's actuarial balance. If additional costs are averaged into the cost rate over 75 years, they might increase it by a small fraction of a percentage point of taxable payroll, depending of course on the form of the legislative proposal.[5] However, this would mean future tax increases might have to be considered sooner than would be the case in the absence of notch legislation. Furthermore, if future tax increases to fund increased benefits resulting from notch legislation were spread over a shorter period than 75 years, it follows that such increases would be greater than those shown employing 75-year projections.

WHO SHOULD PAY TO CORRECT THE NOTCH?

Some proposals for dealing with the notch issue suggest that those in the group immediately preceding the transition and who benefited from overindexing should share in the cost of notch legislation. While this approach has merit on technical and equity grounds, it would require the Congress to reconsider it's decision not to have then-current retirees or those very close to retirement affected by a change in the benefit formula. Also, this alternative was more feasible during the earlier debate on the notch issue. As mortality renders the pretransition group smaller over time, there is a smaller base from which to acquire the necessary financing without having a significant impact on individuals.

Also, there are other questions. For example, if notch group benefits were raised retroactively should reductions in pretransition group benefits be retroactive as well? How feasible is it to collect "overpayments" from the pretransition group? Furthermore, retroactivity raises possible problems because of the necessary additional computations that SSA might have to make. How would a specific pretransition group be defined? These are a few of the practical considerations that would have to be addressed in implementing legislation of this type.[6]

Another alternative for financing notch legislation is to raise payroll taxes. This adds another dimension to the debate concerning who should pay if notch legislation is warranted. Social security can be largely characterized by a current-cost ("pay as you go") concept; current workers pay taxes to finance the benefits of current retirees. A worker's taxes are not held in reserve for that worker's retirement. The current-cost concept underlies the role of the OASDI Trust Funds as a contingency reserve, although the system has not operated as such historically and may not in the future.

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[5] SSA estimates of the additional cost as a percentage of taxable payroll of the notch legislation discussed in chapter 5 are: H.R. 121/1721 (Daub), .02; H.R. 1917 (Roybal), .08; and S.1830/H.R. 3788 (Sanford/Ford), .07.

[6] Although such "implementation issues" were not a direct focus of our study, SSA officials indicate that notch legislation could have a significant effect on their operations, depending on the form of legislation. For instance, the number of recomputations needed to provide additional benefits under notch legislation could exceed the capacity of the existing computerized system, thus requiring benefits to be calculated by hand. Also, GAO recently reviewed a number of aspects of SSA's operations in light of a planned reduction of 17,000 staff over 5 years. Such matters could warrant further review should notch legislation be adopted.

With the overindexed pre-1977 formula, then-current workers contributed to pay higher-than-anticipated benefits to retirees. Some of these individuals would retire later during the transition period. With the corrected 1977 formula, current workers then paid more appropriate benefits to transition group retirees. Thus, it is not inconsistent for some in the transition group to argue that they paid higher taxes during part of their working years and received lower benefits after retirement. In this context, what the transition group is essentially asking is for current workers to contribute to paying benefits more comparable to those received by the pretransition group. Because of the need to correct the benefit formula in the context of a current-cost system, there must be some group willing, or required, to accept a slight lowering of benefits relative to taxes paid. Whatever the merit of various notch legislation, most of the major proposals attempt to shift the burden of paying to "correct" the benefit formula off into the future.

The financing of notch legislation becomes even more complicated because of the long-term financing strategies adopted in the 1977 and 1983 Amendments. These amendments attempted to correct the long-run financing of social security by addressing the effects of adverse demographic conditions expected to occur when the Baby Boom generation retires in the early part of the 21st century. The solution was to adopt provisions aimed at the accumulation of higher trust fund balances in the nearer term that could lessen the need to increase future tax rates for future workers to pay for the Baby Boom's retirement. The higher balances are to be accumulated through the current Baby Boom generation paying higher taxes than would be necessary under strictly current-cost financing.

But this means that current workers, who already are paying higher taxes than necessary to partially fund future benefits also would be required to pay higher taxes to finance higher benefits for the notch group. Such an imposition of additional taxes on current workers can be viewed as inequitable.

Furthermore, to use accumulating reserves to compensate the notch group brings us again to the position of shifting costs to future workers in the form of higher taxes to finance the benefits of the Baby Boom.

In essence, a resolution of the notch issue is caught between the Congress's past decisions not to penalize those who benefited from the overindexed formula and to have current workers pay higher taxes to finance a portion of their future benefits and mitigate an otherwise more severe potential payroll tax burden on future workers. In considering the financial implications of legislation to address the notch issue, the Congress will have to reassess some of its past decisions.[7]

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[7] For another discussion of the policy problem of the notch, see Robert M. Ball and Robert J. Myers, "Notch-Babies and Bonanza-Babies, A $300 Billion Misunderstanding," reprinted in *The Congressional Record*, May 6, 1987, pp. H3246–47.

CHAPTER 7—WHO WOULD BENEFIT FROM NOTCH LEGISLATION? SOCIOECONOMIC DATA RELATING TO THE NOTCH GROUP

In requesting a comprehensive study of the notch issue, the Chairman of the Subcommittee on Social Security, House Committee on Ways and Means asked us to compile socioeconomic information relating to the notch group.[1] In our analysis, we sought to relate the characteristics of those affected by the notch to the degree to which they may be affected by the disparity in benefits. Such an analysis focuses on how the pattern of notch disparity compares with the pattern of benefit recipients' income, assets, and health status. For example, are those with larger disparities likely to have smaller or larger incomes, hold more or fewer assets, and have better or poorer health? As agreed with the Chairman's office, we reviewed several sources of data on the social security recipient population and selected SSA's New Beneficiary Survey (NBS) as containing the most complete information of the type requested.

Of the beneficiaries affected by the notch, those likely to have larger disparities attributable to it tend to have higher incomes, greater asset holdings, and fewer health problems than those likely to have only small notch disparities. We caution that our analysis deals with general patterns in the data; many individuals do not fit these patterns.

SSA'S NEW BENEFICIARY SURVEY

The NBS, conducted by SSA in 1982, is based on a sample of those who first received social security benefits during the period mid-1980 to mid-1981. It is a nationally representative survey of households, randomly selected from SSA's Master Beneficiary Record and encompassing representative samples of major beneficiary categories. After interviewing beneficiaries from October through December 1982, SSA linked their responses to administrative data on benefit status. Separate samples were collected from men and women, ages 62, 63–64, 65, 66, and older. Information compiled in the NBS covers the following general categories:

1. Household composition,
2. Employment history/job characteristics,
3. Health status,
4. Sources and amounts of current income,
5. Asset holdings and asset income,
6. Marital history and information on respondents' spouses, and

[1] For the Chairman's request letter, see app. I and for background information on our data analysis effort, app. II.

7. Primary insurance amounts and monthly benefit amounts (MBA).

USING THE NBS DATA TO EXAMINE THE NOTCH GROUP

While the NBS is quite useful for its information on beneficiaries and socioeconomic variables, it is a single survey. Unlike a longitudinal survey, the NBS has data for only individuals first receiving benefits in the period mid-1980 to mid-1981.[2] Furthermore, the notch is associated with the transition group, i.e., those born in the years 1917–1921 who first became eligible for benefits during the years 1979–1983. Thus, the NBS sample essentially cuts through the transition group, which prevents us from obtaining a complete cross section of the transition group.[3]

While the NBS has excellent data from beneficiary records, further complications arise in defining the notch disparity. There are different ways to view this, as we indicate in chapter 4.[4]

STRUCTURE OF THE ANALYSIS

In compiling data on the notch group, we focused on the notch as a disparity in benefit awards between adjacent birth cohorts (i.e., 1916 and 1917). Hypothetical but typical steady earner cases showed a clear pattern in terms of retirement age (i.e., first benefit receipt) and benefit or PIA level. The later the age at which a transition group (i.e., 1917) individual retires, the greater tends to be the nominal dollar disparity in benefits compared with a closely adjacent old law (i.e., 1916) retiree (see table 7.1). Also, the higher an individual's lifetime covered earnings and hence his/her PIA level, the higher tends to be the nominal dollar disparity compared to the old law retiree. Table 7.1 shows the distribution of notch disparity (in percentage terms and dollar amounts) by retirement age and earnings/PIA category based on data presented in chapter 4. Across earnings' categories, the disparities display the following patterns:

- Age 62—1–2 percent
- Age 63/64—5–10 percent

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[2] In this chapter, we group data by "retirement age" although the more technically correct term in the NBS is "age at first benefit receipt." We use "retirement age" for convenience although we recognize that retirement is a broader concept encompassing more factors and conditions than receipt of social security benefits.

[3] The NBS includes what we might call "early notchers," those retiring at ages 62–64. Conversely, the NBS includes some retirees not in the transition group, "late retiring prenotchers," born in 1916 and earlier and retiring in the period mid-1980 to mid-1981. Some of these individuals may be age 63 at retirement (if born in late 1916), some will be 64 (those born in late 1916), some will be 64 (those born in early 1916 and late 1915), some will be 65 (those born in early 1915 and late 1914), and the rest will be late retirees 66 and older. These "prenotch" individuals receive benefits under the pre-1977 formula.

[4] Among the different ways to view or define the benefit disparities are to compare:

1. closely adjacent 1916 and 1917 birth year retirees,
2. current-dollar initial benefit awards between cohorts with reference to the 1916 birth year cohort,
3. constant-dollar benefit awards,
4. replacement rates,
5. benefits under the transitional guarantee/new law formula with the (hypothetical) benefit that would have been received by individuals had the old law continued in effect.

Given the limitations of the data sources, we chose not to pursue the analysis using all of these definitions. The first definition above represents the clearest statement of the technical notch problem and is the one upon which our analysis focuses.

- Age 65—11-14 percent
- Age 66—12-17 percent

Thus, grouping individuals by retirement age and PIA level allows us to broadly classify those likely to experience a higher nominal dollar disparity. Our basic approach, then, was to compare in a general way the pattern of notch disparity represented in table 7.1 with patterns in various socioeconomic variables to learn how individuals' likely disparities vary in relation to their income, assets, and health status. To the extent that notch legislation reduces the disparities proportionally, the analysis provides information about the characteristics of those likely to benefit most from notch legislation.[5]

Table 7.1.—Differences in Benefit Awards Between 1917 and 1916 Cohorts

Retirement age	Differences in monthly benefits,* for typical earner cases					
	Low earner		Average earner		Maximum earner	
	Dollars	Percent	Dollars	Percent	Dollars	Percent
62	$-3	-1.4	$-6	-1.9	$-7	-1.8
63	-12	-4.7	-24	-6.2	-30	-6.1
64	-26	-8.0	-51	-10.2	-66	-10.4
65	-45	-11.3	-88	-14.1	-111	-14.1
66	-57	-12.7	-124	-17.3	-146	-16.2

* Based on data presented in ch. 4.

The NBS sample contains over 18,000 respondents, including male and female retired workers, disabled workers, and those receiving dependent and Medicare benefits. Retired workers are grouped into categories by age of retirement: 62, 63–64, 65, and 66 and over.

To study patterns in variables in relation to the notch disparity, we selected a subgroup of 5,307 male retired workers, age 62 and over. Using information on the distribution of PIAs (benefits), we divided the male retired worker subsample into four monthly PIA

[5] Given the lack of a complete cross section of transition group individuals in the NBS, we employed a simplifying assumption that permitted us to use the NBS data to draw some inferences regarding the notch group. We assumed that those retiring at a given age and earnings/PIA level but in closely adjacent years are unlikely to have significant differences in their overall socioeconomic profile. In other words, in the aggregate a cohort retiring at for example, age 65, in a given year is not likely to differ significantly in terms of income and other aspects compared with an age 65 cohort retiring a few years earlier. This assumption permitted us to use a single survey such as the NBS and apply our observations to the notch group. It is as if we took the cross section available in the NBS and assumed that the profile of this group was essentially similar to the transition group. Such an assumption is consistent with a common characterization of the notch problem: "How can two individuals who do not differ in age at retirement and in lifetime earnings except that they were born in different years, receive significantly different social security benefit amounts?" Using this assumption and NBS data, our analysis groups individuals by age of retirement and PIA level. We then examine how socioeconomic variables vary by these categories.

categories: low, low/middle, high/middle, and high (see table 7.2 for their distribution).[6, 7]

Within each age category, we sorted the sample by PIA categories (see table 7.3). The mean PIA generally was higher for later-age retirees. Translated into annual amounts, these PIAs represented social security income of about $3,350 on average for an individual in the lowest PIA/age 62 category, and just over $10,000 on average for the highest PIA/66 and over category. To get a more complete view of the economic status of the elderly, however, we needed to look at other aspects of income as well.

Table 7.2.—Distribution of NBS Male Retired Workers, by Retirement Age and PIA

Characteristic	Distribution (percent)
Age at retirement:	
62	27.2
63–64	27.6
65	26.2
66+	19.0
PIA category:	
Low	25.1
Low/middle	24.9
High/middle	26.5
High	23.6

Table 7.3.—Monthly Primary Insurance Amount for Male Retired Workers, by PIA and Retirement Age (in 1982)

	Mean monthly PIA, by PIA category[a] →			
Retirement age[a]	Low	Low/middle	High/middle	High
62	$279	$496	$610	$669
63-64	369	601	706	770
65	425	707	776	809
66+	369	737	800	837

Source: NBS

n = 5,307

[a]Arrows show increasing notch disparity

[6] The PIA variable represents the PIA for the end of the third part of the survey representing Jan.-Dec. 1982. We divided the PIA categories using the quartiles of the PIA distribution for each age group. Thus, the low/middle and high/middle PIA categories are divided at the median, while the low PIA category represents the 25th percentile and the high PIA category, the 75th and above percentile. It is useful to make four categories, as the lowest PIA category is likely to include a fair percentage of those who lack many years of covered earnings, perhaps because they were not working in covered employment for most of their careers even though their earnings were not low over their careers.

[7] The distribution of NBS respondents by retirement age (age at first benefit receipt) in table 7.2 is unweighted. This accounts for the fact that the distribution by age is fairly uniform. If NBS weights were applied to represent the universe of new beneficiaries, the distribution would be different. For example, about 48 percent of men would be in the 62-year-old category and men 66 and older would represent only 9 percent of new beneficiaries. Also, the PIA distribution can be considered a proxy for the extent of notch disparity, as can retirement age. Thus, the joint distribution provides a slightly better framework for representing *dollar* disparities than either PIA or retirement age alone.

INCOME LEVELS

The NBS produced extensive data, presented on a quarterly basis, on the sources of income of new recipients. The summary income variables we chose, which include the income of the spouse, represent a measure of household income. Household income is important in determining economic status, and, out of 5307 NBS male respondents retiring at age 62 and older, 4,483 or 85 percent were married. Thus, we restricted our analysis to married males (and their wives). The income variables we reviewed and discuss are: total income, total retirement income, total pension income (other than social security), and asset income.

Table 7.4.—Quarterly Income of Married Male Retired Workers Age 62 and Over, by PIA and Retirement Age (in 1982)

	Mean quarterly income, by PIA category[a] →			
Retirement age[a]	Low	Low/middle	High/middle	High
62	$3,951	$4,347	$4,925	$5,775
63-64	4,704	5,286	5,761	6,066
65	5,254	5,849	6,246	7,403
66+	5,237	7,379	9,171	10,447

Source: NBS

n = 4,483

[a]Arrows show increasing notch disparity.

Total Income

Data on the mean total quarterly income of the married male retired worker subsample (representing income levels in 1982) appear in table 7.4. Fig. 7.1 shows the distribution of the subsample by income category. Included in total income are social security and pension benefits from public and private sources, earnings, asset income, government program and welfare benefits including SSI, and income from various other sources.[8]

Total quarterly income averaged $3,951 for beneficiaries who retired at 62 and were in the lowest earning category and $4,347 for those in the next quartile of the age 62/PIA distribution. Mean total quarterly income was highest for those who retired at later ages (66 and over) and were high lifetime earners. For this group, those in the top two PIA categories averaged (respectively) $9,171 and $10,447 in quarterly income. Assuming the quarterly income continued at the same level in the other quarters of the year, those in the age 62/low middle PIA category would have had an annual income of over $17,000 and those in the age 66 and over/high

[8] One potential concern in using the NBS to study the notch group is that, as discussed in footnote 3, the NBS sample included some individuals who had benefits computed under the old law and some who used the transition/new law formula. This may affect the income data discussed here to the extent that those under the new law receive relatively lower benefits. In other words, the differences between high and low income might be somewhat wider than if we had a complete cross section of only those under the old law or only those in the transition group. Those who are in the NBS and in the transition group will be those who retire "earlier" (i.e., before age 65). This group tends to have smaller notch disparities than those who retire at later ages, which mitigates the impact on income resulting from this characteristic of the NBS.

middle PIA group, almost $37,000. For the age 65 group, mean income of around $6,000 implies an annual income of about $24,000.

Even for the earlier retirees, in the lower PIA categories of this subsample, average incomes were well above the Census Bureau's poverty line. In 1982 (the year relevant to the NBS data), the poverty level for a couple with an aged head of household was $5,836 in annual income. In our subsample, an age 62/low middle PIA retiree had a higher implied annual income—over $17,000. We caution that, with each age/PIA group, there can be substantial variation in incomes, and average income is not as high for those not married or disabled. Thus, these data do not mean that all retirees are financially comfortable.

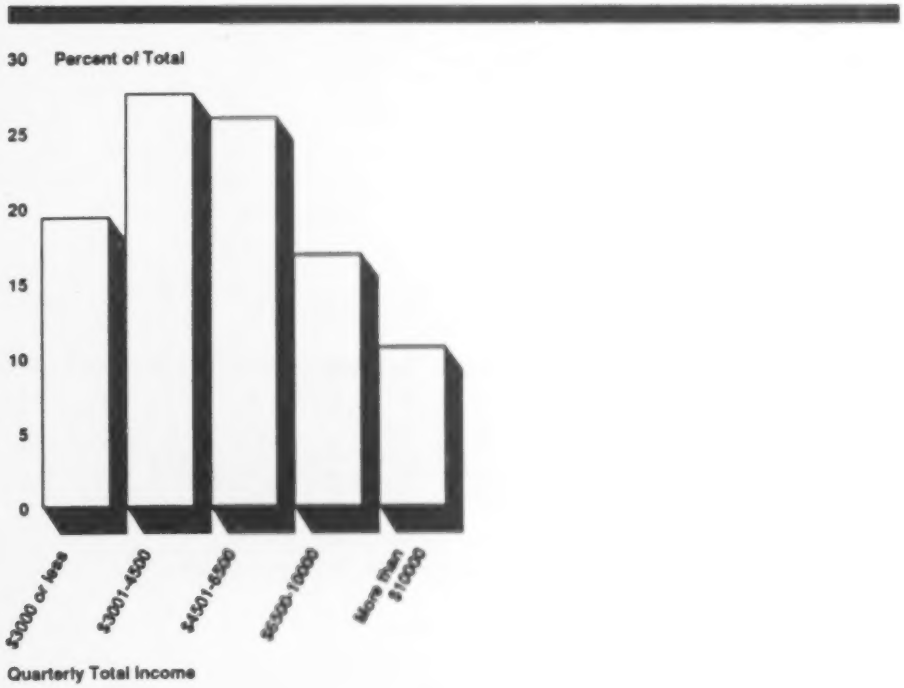

Figure 7.1: Distribution of Quarterly Total Income for Married Male Retired Workers in New Beneficiary Survey

However, our main concern was with the patterns of variables in relation to the likely pattern of notch disparity. Mean income is higher for those with higher PIAs, the data show—not a surprising result. Also, those who retired later tended to have higher mean incomes. This was likely associated with more years of work, perhaps at high wage levels. Beneficiaries likely to experience large benefit disparities (in dollar amounts and percentages) associated with the notch also were likely to have higher average incomes. Again, this does not mean that the notch had no impact on those individuals or that no individuals in the later retiree category had their standard of living affected by the disparity.

Components of Total Income

Data for other portions of total quarterly income appear in tables 7.5 through 7.7. These include retirement income, pension income other than social security, and asset income. Total retirement income, which excludes earnings, represents a measure of the "long-term" income the elderly have if not working. In the early retiree/low PIA categories, quarterly incomes were in the $3–4,000 range or approximated annually at about $12–16,000. When earnings are excluded, those experiencing the biggest difference were the later retirees, except for the lowest PIA categories. Thus, late retirees tended to be getting a substantial portion of their income from earnings. Again, when compared with the pattern of notch disparity this concept of income showed the same pattern as did total income.

Private and other public pensions were important sources of retirement income for many (see table 7.6). Those in the low PIA category had rather high percentages of retirement income coming from pensions other than social security. This reflects the high frequency of those receiving some type of public pension (such as Federal, State, or local government) who lack extensive social security coverage. This was one reason for defining four rather than three typical earner categories.

Table 7.5.—Quarterly Retirement Income of Married Male Retired Workers, by PIA and Retirement Age (in 1982)

Retirement age[a]	Mean quarterly retirement income, by PIA category[a]			
	Low	Low/middle	High/middle	High
62	$3,031	$2,967	$4,023	$4,897
63-64	3,236	3,497	4,767	4,910
65	3,856	3,827	4,892	6,472
66+	4,241	4,853	5,900	7,558

Source: NBS

n = 4,483

[a]Arrows show increasing notch disparity.

It is useful to review the data on the other three categories, which were more representative of individuals who receive most of their retirement income from social security.[9] Among these categories, pension income represented 11–32 percent of total retirement income. Later retiring/high PIA individuals tended to receive a smaller percentage of total retirement income from pensions and those retiring at age 62, higher portions from pensions.

These pension data do not display the strong association with the notch disparity that we found for total income, but some patterns are interesting. As age 62 retirees received a relatively high percentage of retirement income from other pensions, perhaps they retired earlier because of this additional income source. Those who

[9] Although there can be many in the lowest category who received only social security benefits.

Table 7.6.—Quarterly Pension Income Other Than Social Security of Married Male Retired Workers, by PIA and Retirement Age (in 1982)

Retirement age[a]	Mean quarterly pension income (non-SS), by PIA category (percent of total retirement income)[a]			
	Low	Low/middle	High/middle	High
62	$1,345 (44.4)	$805 (27.1)	$1,141 (28.4)	$1,548 (31.6)
63-64	1,097 (33.9)	471 (13.5)	1,047 (22.0)	923 (18.8)
65	1,294 (33.6)	625 (16.3)	886 (18.1)	1,585 (24.5)
66+	1,786 (42.1)	639 (13.2)	631 (10.7)	1,066 (14.1)

Source: NBS

n = 4,483

[a]Arrows show increasing notch disparity

retired after 65 tended to average relatively lower amounts of income from pensions; thus social security, earnings, and asset income were more important retirement income sources. For those age 65 in the highest PIA category, pensions represented about one-fourth of retirement income.

The pattern of asset income across the joint retirement age/PIA distribution corresponds to the pattern found with total income (see table 7.7). Those likely to have higher notch disparities tend to have higher asset income both in absolute terms and as a share of retirement income. Income from assets includes income from financial and real property assets and other sources such as trusts, royalties, and IRA/Keogh accounts.

The mean quarterly asset income ranged from $679 for age 62/lowest PIA retirees to $3,306 for age 66 and over/highest PIA retirees. Asset income represented a substantial and relatively constant portion of total retirement income, ranging between 19 to 30 percent for age 62 through 65 retirees. For age 66 and over retirees in all but the lowest PIA category, asset income represented over 30 percent of total retirement income and, for the highest earners, almost 44 percent.

ASSET HOLDINGS

The asset income variable discussed above measures the flow of income from individual asset holdings. We also reviewed data on asset holdings, an important dimension of the economic status of the elderly. The pattern of holdings also is compared to the pattern of notch disparity. Almost all of those in the NBS married male subsample had some assets, mostly in the form of savings accounts and home equity. A significant but much lesser proportion had such financial assets as money market accounts, certificates of deposit, stocks, and bonds.

Table 7.7.—Quarterly Asset Income of Married Male Retired Workers, by PIA and Retirement Age (in 1982)

Retirement age[a]	Mean quarterly asset income, by PIA category (percent of total retirement income)[a]			
	Low	Low/middle	High/middle	High
62	$679 (22.4)	$572 (19.3)	$962 (23.9)	$1,288 (26.3)
63-64	852 (26.3)	973 (27.8)	1,353 (28.4)	1,309 (26.7)
65	1,021 (26.5)	859 (22.4)	1,319 (27.0)	1,947 (30.1)
66+	954 (22.5)	1,524 (31.4)	2,270 (38.5)	3,306 (43.7)

Source: NBS

n = 4,483

[a]Arrows show increasing notch disparity

The distribution for savings and home equity by retirement age/PIA level reflects the pattern found earlier for income in relation to the notch disparity. Those who retired later and/or had higher PIAs tended on average to hold larger amounts of assets. Our data thus confirms that those who are likely to have large nominal dollar disparities arising from the notch tend to be those who, on average, have greater asset holdings.

Of the married male retired worker subsample, 98 percent had some net worth including equity in a home (see table 7.8) and, excluding the home, 94.2 percent still had some net worth. A large portion of the subsample also had equity in a home (87.2 percent), and 93.7 percent had some financial assets. Among financial assets, almost 93 percent had some form of savings account, checking, or credit union account. Lesser but still significant proportions had money market accounts or certificates of deposit (44.9 percent), and 32.2 percent held stocks and/or bonds.

Data for the average value of home equity appear in table 7.9. Mean home equity ranged between $36,000 and $66,000 for retirees with PIA levels below the median (see table 7.9). For those with above-median PIAs, values ranged from $54,000 to over $100,000 for the age 66 and over/highest PIA retiree category.

Table 7.8.—Possession of Assets by Married Male Retired Workers, 62 and Older

Asset	Number (percent)	
	Yes	No
Net worth, including home	4,397 (98.0)	86 (1.9)
Net worth, excluding home	4,224 (94.2)	259 (5.8)
Equity in home	3,913 (87.2)	570 (12.7)
Financial assets	4,205	278

Table 7.8.—Possession of Assets by Married Male Retired Workers, 62 and Older—Continued

Asset	Number (percent)	
	Yes	No
	(93.7)	(6.2)
Savings or checking account	4,163	320
	(92.8)	(7.1)
Money market account or certificate of deposit	2,468	2,015
	(55.0)	(44.9)
Stocks or bonds	1,443	3,040
	(32.2)	(67.8)

Source.—NBS
n = 4,483

Table 7.9.—Home Equity of Married Male Retired Workers, by PIA and Retirement Age (in 1982)

Retirement age[a]	Mean home equity, by PIA category[a]			
	Low	Low/middle	High/middle	High
62	$36,230	$40,189	$55,924	$55,338
63-64	42,056	43,975	54,164	56,740
65	48,521	54,620	58,418	64,801
66+	39,876	65,525	69,859	100,238

Source: NBS

n = 4,483

[a]Arrows show increasing notch disparity

Other financial assets are likely to be considerably more liquid than home equity and thus represent a better indication of economic well-being in retirement (see table 7.10). Retirees with below-median PIAs generally had financial wealth in the $16–30,000 range. Those above the median PIA had financial assets in the $50-100,000+ range. Those who retired at age 65 in the highest earner category averaged $88,898 in financial assets. For retirees who retired after 65 and were above the median PIA, assets averaged $102,835 for the high/middle PIA group and $154,373 for the highest PIA category.

The data further confirm the pattern seen with total income. Those who retired later and had higher PIAs tended to have greater assets. Thus, those likely to have experienced a greater notch disparity on average had considerable net worth in a home and substantial financial assets. This pattern was also true of stock and bond holdings although to a somewhat lesser extent (see table 7.11).

HEALTH STATUS

While the notch issue clearly relates to the economic status of retirees, data on their health status can give us some indication of their overall well being. Determining health status and its implications is difficult and dealing with its intricacies is well beyond the scope of this analysis. However, we did analyze some health data

Table 7.10.—Financial Assets of Married Male Retired Workers, by PIA and Retirement Age (in 1982)

Retirement age[a]	Mean financial assets, by PIA category[a]			
	Low	Low/middle	High/middle	High
62	$16,047	$22,541	$67,914	$55,216
63-64	34,281	32,762	51,707	56,292
65	32,744	34,447	52,205	88,898
66+	36,870	63,149	102,835	154,373

Source: NBS

n = 4,483

[a]Arrows show increasing notch disparity

Table 7.11.—Value of Stock and Bond Holdings of Married Male Retired Workers, by PIA and Retirement Age (in 1982)

Retirement age[a]	Mean value of stock and bond holdings, by PIA category[a]			
	Low	Low/middle	High/middle	High
62	$2,321	$7,042	$40,758	$16,531
63-64	3,509	11,181	11,442	16,178
65	9,874	6,460	13,937	31,212
66+	12,200	19,656	39,267	62,390

Source: NBS

n = 4,483

[a]Arrows show increasing notch disparity

collected in the NBS and compared patterns in the data with the pattern of notch disparity, as discussed below.

Number of Health Problems

The NBS surveyed respondents on the number of health problems they experienced.[10] The data show that one-fifth of our subsample of retirees cite no health problems (see table 7.12). One-fourth of the subsample cited one health problem, and 21 percent said they had two. One-third of the sample reported having three or more health problems.

Table 7.12.—Number of Health Problems Reported by Male Retired Workers, 62 and Over

No. of problems cited	No. of retired workers	Percent of male subsample
0	1,081	20.4
1	1,360	25.6
2	1,117	21.1

[10] For a listing of the health problems on which NBS respondents were queried, see app. VI.

Table 7.12.—Number of Health Problems Reported by Male Retired Workers, 62 and Over—Continued

No. of problems cited	No. of retired workers	Percent of male subsample
3	790	14.9
4	463	8.7
5	272	5.1
More than 5	224	4.2

Source.—NBS
n = 5,307

Taking the number of health problems as an indicator of health status, we reviewed data by retirement age/PIA level to compare patterns of health problems and notch disparity. For those reporting no health problems, we found a fairly uniform distribution across retirement age/PIA level. Slightly higher percentages of "healthy" individuals tended to be found in the age 65, higher PIA categories.

The lack of a strongly discernible pattern regarding the notch disparity is also present among those reporting one or two health problems. However, when those reporting three or more health problems were considered, a more noticeable pattern began to emerge. A greater frequency of such retirees was found in the earlier age categories. Also, those with greater health problems tended to concentrate in the lower PIA categories. For example, those reporting six health problems constituted about 2.5 percent of the male subsample. Of this group, 38 percent were in the age 62/lower PIA and age 63/64/lowest PIA categories. Such patterns suggest that those who are in poorer health tend to retire early and tend to be less well off economically (at least in terms of what they receive from social security). Those are the same individuals who are less likely to benefit from any increase in benefits due to notch legislation because they had the lowest notch disparities.

Activity Limitations

The NBS surveyed individuals concerning their ability to perform a variety of daily activities (see table 7.13).[11] Almost 65 percent of the subsample could perform all the daily activities, while just over one-third (35 percent) were unable to perform at least one of the activities. Within the former category, we did not find a strong pattern across retirement age/PIA categories. A slightly higher concentration was found in the age 63/64, age 65, and higher earner categories. A more discernible pattern emerged for the latter group—those with activity limitations. As those with some limitations tended to be more concentrated in the earlier retiree and lower PIA categories, they are less likely to be substantially affected by the notch disparity or notch legislation.

[11] These activities include walking distances or flights of stairs; stooping, crouching, or kneeling; standing or sitting for long periods; lifting or carrying objects of various weights; and reaching and grasping.

Table 7.13.—Ability of Male Retired Workers, 62 and Over, to Perform Daily Activities

[In percent]

Category	No limitation	At least one limitation
Retirement age:		
62	23.7	33.6
63–64	28.0	26.9
65	29.0	20.9
66+	19.2	18.7
PIA level:		
Low	21.6	31.5
Low/middle	24.8	25.0
High/middle	27.6	24.3
High	26.0	19.1
All	**64.8**	**35.2**

Source.—NBS
n = 5,307

CHAPTER 8—CONCLUSIONS AND GUIDELINES FOR FURTHER CONSIDERATION OF THE NOTCH ISSUE

After considerable study, analysis, and policy debate over the past 9 years, the notch issue has remained unresolved. It is characterized by the technical complexity involved in devising a formula to award benefits that are adequate, equitable, and consistent across cohorts of retirees, while ensuring the social security system's continued solvency. Efforts to pursue a benefit structure that meets these objectives have led the Congress to pass legislation in 1972 and 1977 changing the benefit formula and to consider new legislation addressing the unanticipated disparities arising out of the 1977 changes. The changes made in the benefit formula in 1972 helped improve the economic status of the elderly,[1] while the changes in 1977 helped assure that benefits would be equitable across future cohorts of beneficiaries and not be excessively burdensome to current and future workers. The 1977 Amendments have been generally successful in achieving their major goal of stabilizing replacement rates. Still, as we have documented, there can be benefit disparities between some members of adjacent retiree cohorts that are significant in dollar amounts, and this has created controversy.

THE TRANSITION PROVISIONS GENERALLY WORKED AS INTENDED

To address the problems related to the 1972 benefit formula, the Congress sought to stabilize future replacement rates and in the nearer term, lower replacement rates from the levels they reached in the mid- to late-1970s. It also intended to move future retirees into the new formula rapidly. Whether it was well understood how the transition between formulas would work once the 1977 legislation was implemented is unclear. Disparities between adjacent cohorts of retirees developed mainly because of:

- the new benefit provisions, which reflected the intent to lower replacement rates;
- the separation, by birthdate, of those who would continue to use the old formula and those who were subject to the new law/transition provision; and
- higher-than-anticipated inflation subsequent to the implementation of the new law.

The benefit differences that developed are most clearly demonstrated by comparing adjacent 1916 and 1917 birth cohorts. Those born in 1917 who retire under the new law receive generally lower

[1] Michael Hurd and John Shoven, "The Economic Status of the Elderly," in Z. Bodie and J. Shoven, *Financial Aspects of the United States Pension System* (Chicago: National Bureau of Economic Research and University of Chicago Press, 1983).

benefits than those born in 1916, except that there is virtually no difference for age 62 retirees. Those who retire at later ages and who have higher PIAs (based on higher lifetime earnings) tend to have larger benefit differences than those who retire earlier at lower PIA levels.

An important factor in the design of the transition provisions was the exclusion of post-age 61 earnings from the transitional guarantee. Individuals who worked longer and retired later did not have these earnings included in the benefit computation using the transitional guarantee. While this feature of the transitional guarantee may not be fully consistent with the goal of decoupling, it was intended principally as a means of phasing out the transitional guarantee. This objective was accomplished, though somewhat more abruptly than expected. Nevertheless, the intended reduction of replacement rates meant that some disparities between certain members of adjacent cohorts were still likely.

It is also important to consider how the transition provisions interacted with economic conditions as well as the setting of the new law's implementation date by age of eligibility (birth date). This latter element created a sharp break between those who could use the old law formula and those who came under the new law/transition provisions.

Subsequent to the 1977 Amendments, economic conditions worsened as the economy experienced higher-than-anticipated inflation along with prices rising more rapidly than wages. Retirees under the old law continued to receive the advantage of an overindexed formula. Inflation also helped the new wage-indexed formula to yield higher benefit levels more quickly compared with the transitional guarantee, which was (by design) largely unaffected by inflation and excluded post-age 61 earnings. Thus, allowing some retirees (pre-1917 birth year) to use the old formula, combined with higher than anticipated inflation, interacted with the way the transition provisions were designed to make the resulting disparities between adjacent cohorts even greater for some individuals.

It is important to recognize, however, that while those in the transition group receive lower relative benefits, they often compare their benefits to those of other individuals in the cohorts immediately prior to the transition who receive much higher benefits than ever were anticipated. Also, many in the transition group receive higher relative benefits than those who retired after them and who are fully under the new law formula.

The goal of the 1977 legislation was to lower the growth of benefits to a level consistent with the historical goals of the social security program and to ensure adequate financing of the system. In achieving stable replacement rates, the goal of the benefit formula revision was fulfilled.

OTHER FACTS NEED TO BE CONSIDERED

While there are technical reasons for the existence of a notch disparity and ample data to document it, many who claim to be affected by the notch may not be or may be no worse off relative to many others. Misinformation and misunderstanding about this

issue has further led many to perceive that they are not being dealt with fairly. However, certain facts should be considered:

- *Many in the transition group received higher replacement rates than many other social security retirees received historically.*

  Replacement rates rose markedly between the early 1970s and the implementation of the new law. The new law put replacement rates on a declining path toward a lower, stabilized level. Thus, many in the transition group receive a higher replacement rate than those retiring before the mid-1970s and those retiring after the transition group. Other data show that, largely as a result of higher inflation, the actual replacement rates received by many in the transition group were much higher than anticipated at the time the 1977 Amendments were passed.

- *Many retirees benefited from the general rise in inflation, relative to many in the working population.*

  After passage of the 1977 Amendments, the economy experienced a resurgence of rapid inflation. Largely through its effect on wages, this higher inflation contributed to higher nominal benefit awards. Inflation usually has the effect of lowering the real incomes (living standards) of those not protected from its effects. But the 1972 Amendments, in introducing automatic cost-of-living adjustments, protected the benefits of retirees from these effects. Thus, while many in the economy suffered real income losses from inflation, many of the elderly in the transition group were protected and gained relative to other groups in society.

- *Some who experience the largest disparities are among those with higher relative income and assets.*

  The pattern of disparities varies by age of retirement and lifetime earnings level. Those who retired at earlier ages and had lower lifetime earnings generally tend to experience smaller notch disparities than those who retire later and had higher lifetime earnings. While individual circumstances vary greatly, and it is difficult to compare the relative well being of individuals, those most harmed by the notch are likely to be those who, on average, have higher retirement incomes and asset holdings.

A POLICY SOLUTION FACES MANY CONSTRAINTS

No amount of technical discussion and sophisticated analysis is sufficient to convince an individual that it is equitable for him to receive a benefit that is $100 less per month than his nearly identical neighbor. In our view, with the benefit of at least 9 years' hindsight it appears that it might have been better to have allowed the inclusion of post-age 61 earnings in the transitional guarantee computation. Data from SSA show that this would have permitted a smoother phase-out for later age retirees (see app. VII). While such

a provision might not have prevented "notches" entirely, it would have alleviated a portion of the problem.[2]

We did not attempt to grapple with the largely theoretical question of when it is appropriate for the government to compensate individuals for "mistakes." There is simple logic to the exemption of pre-1977 retirees from the new rules, even though many received more from the system than was anticipated. When such a "mistake" is corrected, it often seems reasonable to make the correction applicable as soon as possible but to not seriously penalize those who unwittingly benefited from any error.[3] For individuals who are in the transition group and fully under the new law, it seems less wise to repeat the "mistake" of using the old formula either partially or entirely for some, while making the correction of the benefit formula applicable to those far into the future.

The policy problem of correcting the notch must deal with pragmatic and complicated questions of who pays, who benefits, at what cost, and whether a "solution" is administratively feasible and avoids creating further problems that may be as serious as the ones solved. In this context, it is the role of the Congress to weigh the facts and evidence and decide whether some form of compensation is warranted. If the Congress decides that compensation is warranted, it must balance a number of factors in deciding on the appropriate legislative solution.

MATTERS FOR CONSIDERATION BY THE CONGRESS

The Congress should consider the following matters in evaluating legislative proposals concerning the notch issue:

- *The financing of notch legislation should be as neutral as possible in its effect on the Social Security Trust Funds (and, where relevant, the Federal budget).*

  Although the short-run condition of the trust funds is improving, this condition must be viewed with caution for the next few years. Furthermore, while the trust funds are building what appear to be large balances, these are expected to represent only minimum contingency levels by the mid-1990s. "Surplus reserves" will begin to accumulate only after this point. Although these balances appear large in dollar terms and in relation to the estimated cost of some proposed notch legislation, the diminution of the trust funds to finance notch legislation delays (or may preclude) the system's achievement of desirable contingency levels.

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[2] This view is generally consistent with that expressed by Robert Myers, a leading expert on social security (see Myers, p. 331). Myers also notes that the computation of benefits for those born before 1917 should have treated earnings after 1978 under the new law formula. We also note that the use of a "blended" formula such as that suggested by the Hsiao panel seems much more attractive in hindsight.

[3] As an example of this logic, which we caution is not presented as having *direct* relevance to the notch issue, we note a discussion in relation to the social security "retirement test" and the overpayment of benefits, found in Marshall R. Colberg, *The Social Security Retirement Test: Right or Wrong?* (Washington, D.C.: American Enterprise Institute, 1978), pp. 14–15:

"The Social Security Administration has quasi-judicial powers in various matters, including administration of the earnings test. If a beneficiary has been paid too much, there is ample room to forgive him and not recover the overpayment. If recovery 'would defeat the purpose of the program' or 'be against equity and good conscience' or if the recipient (including a survivor) is 'without fault,' repayment may be waived."

The use of the trust funds to finance notch legislation carries some risk in the event that the economy enters a recession. Furthermore, the purpose of building surplus reserves is to partially fund the future benefits of the Baby Boom generation. Use of the trust funds to pay for notch legislation effectively shifts into the future the burden of paying higher benefits to the notch group. That is, future workers may have to pay higher taxes to make up for the funds that may be used up currently to pay higher notch benefits.

If the trust fund accumulations under current law are not used, the remaining options concern some form of additional taxation of current workers or reductions in costs (i.e., reducing the benefits of some other group). Additional payroll taxation does not seem to be a desirable option because current workers are already paying a higher payroll tax rate than necessary under current cost (pay-as-you-go) financing to restore the system's contingency reserves and build the longer term reserves. Also, the condition of the Hospital Insurance Trust Fund suggests that the option of higher payroll taxes might be needed to preserve its solvency in the future.

From an equity standpoint, there seems to be merit to financing any notch legislation at least to a partial degree by reducing the growth in benefits of those who received windfalls through use of the old rules. However, this was rejected some time ago and would require reassessing the decision in the 1977 Amendments to not affect the benefits of the pretransition group. As this group is decreasing in size over time, the potential for significant savings is diminishing. Further, there are likely to be difficulties in deciding to whom the reductions would apply and in implementing them.

Clearly, the issue of financing has presented and still presents the most serious impediment to the adoption of notch legislation assuming that compensation is warranted. The balancing of these factors under our criteria suggests that the cost of any legislative solution must be kept low. One factor to consider is whether to award retroactive benefits; some have suggested that payment of such benefits be eliminated. We agree that this should be considered as part of reducing the cost of any notch legislation.

- *Feasibility of implementation should be given consideration.*

Because the notch issue has spanned quite a few years, the administrative complexity of implementing notch legislation has increased. Such legislation could require SSA to perform recomputations for millions of beneficiaries. This could place an additional burden on an agency that has already experienced recent staff and resource cuts and could likely involve a significant additional expenditure and/or reallocation of resources within the agency. Also, revised transition formulas that appear simple in concept may not be simple to implement. Notch legislation should not be adopted without careful consideration of SSA's ability to efficiently and effectively implement it and bear the associated administrative costs.

- *The transition period should not be lengthened.*

The transition period adopted in 1977 constituted sufficient notice that the benefit formula changed and also provided some beneficiaries with higher benefits than they would have received from the new wage-indexed formula. Consequently, the transition period should not be lengthened further. As we noted, its effective length essentially is determined by the benefit formula provisions themselves. The problem with the transitional guarantee is not so much that the transition period was too short but that the guarantee phased out more abruptly than expected within the 5-year period. Lengthening the transition period would draw more individuals into the controversy and could extend higher benefits to those who now come fully under the correct and stable new law formula.

AGENCY COMMENTS

The Department of Health and Human Services was provided the opportunity to comment on a draft of this report (see app. VIII). Overall, the Department agreed with GAO's findings, but said that more emphasis should be placed on the overcompensation of retirees born just prior to 1917. GAO believes that the issue is sufficiently discussed.

APPENDIX I—CONGRESSIONAL REQUEST LETTER

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
WASHINGTON, DC 20515
SUBCOMMITTEE ON SOCIAL SECURITY

April 30, 1986

Honorable Charles A. Bowsher
Comptroller General of the United States
General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Bowsher:

As you may know, the "notch" in benefit levels that resulted from the Social Security Amendments of 1977 has proven to be a very controversial and confusing subject in the Congress, the media, and the public. As Chairman of the Social Security Subcommittee of the Committee on Ways and Means, I have been approached by many colleagues and constituents on the "notch," and have heard much anecdotal information about its effect on beneficiaries. Before the Congress considers any legislative proposals to lessen or eliminate the "notch," I would like the General Accounting Office (GAO) to conduct a complete investigation of how the "notch" arose, what beneficiaries are affected by it, and what alternatives exist for financing any increase in benefit expenditures that would result from remedial legislation in this area.

Overall, I would like the GAO to organize its study around a number of important questions that would improve our understanding of the causes and effects of the "notch."

First, it is often stated that the 1977 amendments generated enormous unintended effects that Congress did not expect at the time the legislation was enacted. In this regard, I would like to know:

(a) To what degree do the disparities in benefit levels among different age cohorts exceed Congressional expectations, and why did this occur?

(b) Does any specific beneficiary group receive lower real benefits than Congress anticipated, or are the disparities in benefit levels a product of certain beneficiaries receiving more generous benefits than anticipated?

(c) By year of birth, how are typical workers with low, average, and high earnings, respectively, affected by the "notch?"

(d) What would have been the effect on benefits calculated under the transitional rule had economic circumstances been more favorable in the late 1970s?

(e) Has the key objective of the 1977 amendments -- the stabilization of benefit levels in relation to pre-retirement earnings -- been achieved?

Second, I am very interested in a detailed analysis of the social and economic characteristics of the beneficiary groups disadvantaged by the "notch." I would like GAO to examine a sample of the population affected by the "notch," divide the sample into categories based on the amount by which their real benefits are less than they would have been had the 1977 amendments not been enacted, and provide statistics on the income, assets, and health status of each group. I want to know what sorts of people typically receive significantly lower benefits as a result of the 1977 amendments, and what this reduction means from the larger picture of household income and resources. In considering legislation to lessen the effects of the notch, I think Congress would benefit from an analysis of who would gain most by such proposals.

Finally, I would like GAO to look into the financial consequences of legislative proposals that would lessen the discontinuity between benefits paid under the old and new law formulas. I would be interested in a thorough review of the alternatives available to the Congress to finance the benefit increases that would result from such legislation.

I appreciate your attention to this matter.

Sincerely,

JAMES R. JONES
Chairman

APPENDIX II—BACKGROUND ON GAO'S DATA ANALYSIS EFFORT

In his letter of request, the Chairman of the House Committee on Ways and Means, Subcommittee on Social Security, asked us to take a sample of the notch individuals, "stratify" it by the extent to which individuals are affected by the notch, and provide data on the income, assets, and health status of the group and how these characteristics vary by the extent of notch disparity.

Compiling such data presented several problems. Obtaining such comprehensive data on individuals required the satisfaction of a number of key elements. Specifically, the study required the following:

1. Information on individual's social security benefits and status, date and age of retirement, and earnings' history sufficient to calculate benefits under alternative formulas and assumptions and for different time periods.
2. Detailed socioeconomic data on individuals for such variables as income and its components (including other pensions and earnings) and the extent and nature of asset holdings, and information on health status.
3. Data that is longitudinal, i.e., the same individuals should be surveyed over more than one time period in order to study changes over time. Short of this, the data source should be sufficiently comprehensive to permit us to obtain a complete cross section of notch individuals retiring at different ages and time periods.
4. Consistent definition of the notch disparity and to whom the definition applies.

After reviewing several data sources, we determined that no one source could adequately satisfy all the necessary criteria. For example, the Current Population Survey (CPS) and the Survey of Income and Program Participation (SIPP), both compiled by the Bureau of the Census, contain much useful information about the elderly. However, neither of those sources is merged with detailed information from social security beneficiary records.

The CPS samples a large cross section of households in the United States each year and provides detailed information on income and labor force participation. Much of the current CPS data on the aged evolved from earlier efforts by SSA to collect data on older persons; this is reflected in the SSA publication *Income of the Population, 55 and Over.* These earlier data collection efforts by SSA (in the 1970s), which were aimed at linking data on the elderly's economic position with SSA beneficiary record data, culminated in the 1973 CPS-IRS-SSA Exact Match Study. This ambitious effort proved useful but also was beset by technical and legal

issues. Updated information from it is not generally available to the public today.[1]

Another data source we reviewed, SIPP, is longitudinal and encompasses data on households and individuals, their employment history, sources of income including government transfers and financial assets, and extensive socioeconomic information. The Bureau of the Census began the survey in 1983–84 with a sample panel of over 20,000 households and their members. Second and third waves of the study were added during 1985 and 1986. The survey contains a retirement module with extensive socioeconomic data on the elderly. However, SIPP suffers from the same general problem as CPS in that it is not linked with detailed social security beneficiary data sufficient to examine a cohort such as the notch group.

During our review, we learned that there is currently an ongoing effort to link SIPP to social security records. Such a merged set of data no doubt would be close to ideal for our purposes. But Census officials told us that the project is at least 2 or 3 years from completion.[2]

As a result of anticipated difficulties with CPS and SIPP, we focused on SSA's New Beneficiary Survey (NBS) as perhaps the best available source of data applicable to the Chairman's request.[3]

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[1] For an overview of these issues, see Sheldon E. Haber, "A Perspective on Linking SIPP to Administrative and Statistical Records," *Journal of Economic and Social Measurement*, Vol. 13, Nos. 3 and 4, Dec. 1985, pp. 336–7. For information on the Exact Match Study, see Beth Kilss, Fritz Scheuren, Fay Aziz, and Linda DelBane, "The 1973 CPS-IRS-SSA Exact Match Study: Past, Present and Future," in *Policy Analysis with Social Security Research Files, Proceedings*, SSA, 1978.

[2] For more discussion of the project, see Haber (1985) and, in the same publication, Gary S. Fields and George H. Jakubson, "Labor Market Analysis Using SIPP," pp. 281–286.

[3] Fairly extensive research using the NBS has been conducted, and some studies may be relevant to the data discussed in ch. 7. Among these are: Linda Drazga Maxfield, "Income of New Retired- Workers by Age at First Benefit Receipt," *Social Security Bulletin*, July 1985, pp. 7–26; Sally R. Sherman, "Assets of New Retired-Worker Beneficiaries," *Social Security Bulletin*, July 1985, pp. 27–43; and Christine Irick, "Income of New Retired Workers by Social Security Benefit Levels," *Social Security Bulletin*, May 1985, pp. 7–23.

APPENDIX III—THE REPLACEMENT RATE: AN IMPORTANT MEASURE

In analyzing the issues that surround the benefit formula, the most useful analytical concept is the replacement ratio or rate. The replacement rate, which relates an individual's benefit amount (PIA) to his or her preretirement earnings, provides a measure of the percentage of an individual's preretirement living standard that is replaced by retirement benefits. The replacement rate provides a means for comparing benefit amounts across individuals who have varying earnings' histories. It also is possible to link the future behavior of replacement rates to the behavior of required future payroll tax rates in a fairly direct fashion.[1]

The replacement rate provides some information as to whether retirement benefits are "adequate." A rate of 100 percent means that the recipient's benefit fully replaces preretirement earnings. There is no definition of adequate, but in most cases a replacement rate of less than 100 percent is considered adequate. There are several reasons for this; one is that social security benefits generally are not fully taxed. Although such benefits now are taxed for higher income individuals, many recipients' benefits are exempt from State, Federal, and local taxes.[2]

A second reason that replacement rates of less than 100 percent may be considered adequate is that workers may be entitled to retirement income from a pension based on employment for a private company, the government, or from a profit-sharing plan. Somewhat over half of all wage and salary workers are covered by a private pension plan. For those receiving benefits, private pensions replaced 24 percent of average earnings, one survey of private pensions found.[3]

Another reason for a replacement rate of less than 100 percent may be changes in living costs due to retirement. Retirees may move to a less expensive area after retirement and may not incur work-related expenses.

Social security never was intended to provide more than a "floor of economic protection" for the retired. The individual is expected to supplement retirement income through other pensions and private savings. The goal of assuring a socially adequate benefit is reflected in the progressivity of the benefit formula, which provides a

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[1] See Thompson, pp. 497–504.

[2] Social security benefits are implicitly taxed for retirees with earnings above certain limits—the so-called "earnings' test." In 1988, the earnings' test applied to annual earnings of benefit recipients above $8,400 for those age 65–69 and $6,120 for those under age 65. However, these earnings supplement the retiree's retirement income.

[3] In 1983, 49.5 million (56 percent) of 88.2 million nonagricultural wage and salary workers reported they were covered by a private pension plan. See Emily S. Andrews, *The Changing Profile of Pensions in America.* (Washington, D.C.: Employee Benefits Research Institute, 1985), p. 51. Also, data on private pension replacement rates is from *Findings From The Survey of Private Pension Benefit Amounts* (Washington, D.C.: Department of Labor, 1985), p. 1.

higher replacement rate for lower income workers, usually those less able to save.

As a technical tool, the replacement rate must be used with some caution. This particularly applies to the denominator—preretirement earnings. The replacement rate will vary depending on the measure of preretirement earnings used. Quite often, the earnings in the year just prior to retirement are used as a measure. For any particular individual, this may be quite unrealistic, as earnings can vary substantially over a worker's career, but it is generally valid for the hypothetical steady-worker illustrations.

Other measures might be used, and other factors such as taxation could be taken into account in calculating replacement rates. One view is that the replacement ratio should reflect after-tax preretirement earnings, and these should be compared with untaxed benefits. While we agree that this may be more accurate, we did not adjust our data in this manner, largely to maintain consistency with other studies and data.

APPENDIX IV—NOTCH LEGISLATION PROPOSED IN THE 100TH CONGRESS

Bill no.	Principal sponsor	Date introduced
H.R. 121	Rep. Daub (R-NEB)	1/6/87
H.R. 227	Rep. Quillen (R-TN)	1/6/87
H.R. 416	Rep. Roe (D-NJ)	1/6/87
H.R. 1026	Rep. Bilirakis (R-FLA)	2/5/87
H.R. 1027	Rep. Boner (D-TN)	2/5/87
H.R. 1057	Rep. Grey (D-IL)	2/9/87
H.R. 1264	Rep. Morrison (D-CT)	2/25/87
H.R. 1357	Rep. Frank (D-MA)	3/3/87
H.R. 1359	Rep. Frank (D-MA)	3/3/87
H.R. 1721	Rep. Daub (D-NEB)	3/19/87
H.R. 1917	Rep. Roybal (D-CA)	4/2/87
H.R. 2107	Rep. Wortley (R-NY)	4/21/87
H.R. 3788	Rep. Ford (D-TN)	12/17/87
H.Con.Res. 11	Rep. Moakley (D-MA)	1/6/87
H.Con.Res. 15	Rep. Lent (R-NY)	1/6/87
H.Con.Res. 72	Rep. DeLa Garza (D-TX)	3/11/87
S.225	Sen. D'Amato (R-NY)	1/6/87
S.1119	Sen. Specter (R-PA)	5/1/87
S.1830	Sen. Sanford (D-NC)	10/29/87
S.1917	Sen. Heinz (R-PA)	12/3/87

APPENDIX V—ESTIMATED COST OF ADDITIONAL OASDI BENEFIT PAYMENTS UNDER NOTCH BILLS PENDING IN THE 100TH CONGRESS

[Figures are in billions of 1987 dollars]

Year	Notch bill								
	H.R. 227	H.R. 1026	H.R. 1027 [a]	H.R. 1359	H.R. 1721 [b]	H.R. 1917	S.225 [c]	S.1119 [d]	S.1830 [e]
1987	[f]	[g]	[f]	[g]	2.2	15.5	[f]	26+	9.4
1988	17+	[g]	17+	[g]	2.6	5.6	54.9	14–17	4.6
1989	22+	[g]	22+	[g]	2.7	6.5	18.8	17–22	5.3
1990	27+	[g]	27+	[g]	2.8	7.3	22.2	20–27	5.9
1991	33+	[g]	33+	[g]	2.8	7.9	25.7	24–33	6.4
1992	40+	[g]	40+	[g]	2.8	8.3	29.2	27–30	6.8
1993	47+	[g]	47+	[g]	2.8	8.5	32.7	31–47	7.1
1994	55+	[g]	55+	[g]	2.8	8.7	36.3	34–55	7.3
1995	63+	[g]	63+	[g]	2.8	8.9	39.8	38–53	7.4
1996	72+	[g]	72+	[g]	2.8	9.0	43.3	41-72	7.4
Totals, 1987–96	**$379+**		**$379+**		**$24.3**	**$86.4**	**$302.8**	**$284–379**	**$67.5**

[a] Costs for H.R. 1357 would be similar or identical to those shown for H.R. 1027.
[b] Costs are the same for S.1917
[c] Costs for similar bills, H.R. 416, 1057, 2107, and 1264, would vary somewhat from the figures shown for S.225, depending on the specific provisions of each bill (particularly its effective date).
[d] As specific costs were not available, a range of values is shown as a general indication of the expected cost level.
[e] Costs are the same for H.R. 3788
[f] Proposal not adequately specified.
[g] Estimates not yet available.

Source.—SSA, Office of the Actuary.

Note.—Costs shown for H.R. 1917 and 1721 and S.225 are based on the alternative II–B economic assumptions from the 1987 Trustees' Report. All others are based on the II–B assumptions from the 1986 report; updated values would not differ significantly.

APPENDIX VI—HEALTH PROBLEMS SURVEYED IN THE NEW BENEFICIARY SURVEY

The information on the number of health problems experienced by NBS respondents was obtained by asking those surveyed to respond yes or no concerning whether they had any of the following conditions:

a. Blindness or serious trouble seeing with one or both eyes, even when wearing glasses.

b. Cataracts, glaucoma, or any other condition affecting the eye or retina.

c. Deafness or serious trouble hearing with one or both ears, even when wearing a hearing aid.

d. A missing hand, or arm, foot, or leg.

e. Arthritis, rheumatism, or any other condition affecting the bones or muscles.

f. Permanent stiffness or any deformity of the foot, leg, fingers, arm or back.

g. Multiple sclerosis, cerebral palsy, epilepsy, or any other condition affecting the nervous system.

h. Paralysis of any kind not already mentioned above.

i. Asthma, emphysema or any other condition affecting the lungs or respiratory system, including work-related respiratory conditions such as silicosis or pneumoconiosis.

j. Gallbladder, stomach, kidney, or liver trouble, diabetes, or any other condition affecting the digestive system.

k. Cancer or a malignant tumor or growth not already mentioned above.

l. Nervous or emotional problems, or mental illness.

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APPENDIX VII—COMPARISON OF SOCIAL SECURITY BENEFITS FOR RETIREES UNDER CURRENT LAW AND A MODIFICATION OF CURRENT LAW TRANSITION TO INCLUDE POST-AGE 61 EARNINGS

Year of birth	Monthly benefits in 1997 in 1986 dollars [a]					
	Retirement at 62 [b]		Retirement at 65		Retirement at 70 [c]	
	Current law	Alternative	Current law	Alternative	Current law	Alternative
1916 [d]	$484	●	$685	●	$881	●
1917	494	$493	618	$708	765	$977
1918	464	465	594	668	742	907
1919	441	442	564	607	696	806
1920	432	432	550	557	672	734
1921	443	444	561	[e] 562	682	698
1922	451	●	571	●	693	●

[a] Benefits computed for *average* earner, using alternative II–B assumption of *1986 Trustee's Report*.

[b] Benefit includes reduction for early retirement. Benefit under alternative is the same as under current law for age 62 retirees because they do not have any earnings after age 61.

[c] Benefit includes credit for delayed retirement.

[d] Workers born in 1916 and 1922 shown for comparison only. The transition does not apply to them.

[e] Current law benefit payable because it exceeds transitional benefit.

Source.— SSA

APPENDIX VIII—COMMENTS FROM THE DEPARTMENT OF HEALTH AND HUMAN SERVICES

DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Washington, D.C. 20201

MAR 21 1988

Mr. Edward A. Densmore
Deputy Director, Human Resources
Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Densmore:

Enclosed are the Department's comments on your draft report, "Social Security: The Notch Issue." The enclosed comments represent the tentative position of the Department and are subject to reevaluation when the final version of this report is received.

The Department appreciates the opportunity to comment on this draft report before its publication.

Sincerely yours,

Richard P. Kusserow
Inspector General

Enclosure

COMMENTS OF THE DEPARTMENT OF HEALTH AND HUMAN SERVICES ON THE GENERAL ACCOUNTING OFFICE DRAFT REPORT: "SOCIAL SECURITY: THE NOTCH ISSUE"

Overall, the General Accounting Office (GAO) report is a very good effort on a highly technical and complex subject. The report is a generally balanced presentation of the subject. However, we believe the report does not give sufficient emphasis to the extent to which the notch problem is one of windfall benefits being paid to workers who were born in the years 1910-16.

We believe it is critical to recognize that in addition to the question of high cost, all of the recommended solutions to fix the "notch" would involve a degree of poor benefit design being incorporated into the basic structure of the program (i.e., resulting in imbalances or "notches.")

We have many technical comments on the report. At the request of GAO staff, Social Security Administration (SSA) staff met with them to discuss and transmit these technical comments. This arrangement was necessary because of the extremely short time provided to SSA for analysis and comments.

STATEMENT OF SENATOR BOB DOLE
THE NOTCH

As the distinguished Chairman of the Subcommittee has noted, the matter of the so-called "notch" has attracted considerable attention in recent years and was clearly worthy of our very careful and deliberative review.

The "notch" results from the decision made in 1977 by the Carter Administration and Congress to provide a new system of inflation computations to adjust Social Security benefits for inflation. Although special provisions were included to help smooth the transition from the old system to the new system, certain workers attaining age 65 in 1982 or later will get lower benefits than those who attained age 65 in 1981. Let me underscore that there was no intention to penalize these recipients; the "notch" exists because the old law was flawed and really over-adjusted for inflation producing ever-increasing replacement rates, instead of level ones as has been intended. The Congress attempted to correct that error and in doing so created the "notch". Those in the "notch" group have suggested that a gross inequity has resulted which can only be resolved by restoring the benefits to the old levels.

As Senator Moynihan noted, the Government Accounting Office (GAO) completed an exhaustive study on the "notch issue" and confirmed that those retirees born before 1917 receive higher benefits than those born in 1917 and after, <u>but</u> that "notch babies" usually receive more in benefits -- and never less -- than those born after them. The report went on to caution that "solutions that would draw money from the trust fund to increase benefits to the notch group could jeopardize the short-run financial condition of the system".

At today's hearing we are scheduled to hear from the representatives of the National Academy of Social Insurance, who at the request of Senator Moynihan and me, have completed their own critical analysis of the "notch" issue. Interestingly, while their studies were designed differently both the Academy and GAO have arrived at the identical conclusion that nothing should be done to address the "notch".

We are indebted to the Academy and the GAO for their fine work. Needless to say some will be disappointed with their results, but hopefully no one will question the fairness and quality of their efforts.

I, for one, will be happy to receive any further comments and suggestions from those who may disagree with the conclusions reached by the Academy and the GAO. But, I too must caution those who would have us simply resolve the issue by paying the "notch babies" more. For the present generation of retired Americans, the system is generous. To do more and to try and fully correct for the "notch" may place at risk the benefits of those to follow. I would hate to correct a perceived inequity by creating a new one.

Again, my thanks to the Academy, the GAO, and to my distinguished Chairman for their willingness to help us resolve this difficult issue.

EDWARD M. KENNEDY, CHAIRMAN
CLAIBORNE PELL, RHODE ISLAND
HOWARD M. METZENBAUM, OHIO
SPARK M. MATSUNAGA, HAWAII
CHRISTOPHER J. DODD, CONNECTICUT
PAUL SIMON, ILLINOIS
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BROCK ADAMS, WASHINGTON
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ROBERT T. STAFFORD, VERMONT
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THOMAS M. KELLNER, STAFF DIRECTOR AND CHIEF COUNSEL
KRISTINE A. IVERSON, MINORITY STAFF DIRECTOR

United States Senate
COMMITTEE ON LABOR AND
HUMAN RESOURCES
WASHINGTON, DC 20510-6300

January 23, 1989

The Honorable Daniel Patrick Moynihan
Chairman
Subcommittee on Social Security and Family Policy
Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you for holding a hearing on the Social Security notch. I am sorry that I cannot be with you today, but my schedule does not permit it.

As you may know, there is great interest in this issue in my state. Approximately 130,000 Iowans have been affected by the 1977 change in the Social Security Act. During my tenure in the Senate, I have supported legislation which would bring the benefits for those individuals born during the notch years to levels more equitable with those of individuals who became eligible for Social Security before 1979. I remain hopeful that a solution to this situation can be found.

I look forward to reviewing the findings of this hearing, and I would like to work with you and the other members of the Subcommittee on legislation which will address the Social Security notch in a fair and fiscally responsible manner.

Again, thank you for holding this hearing.

Sincerely,

Tom Harkin

Tom Harkin
United States Senator

Prepared Statement of Eugene Lehrmann

The American Association of Retired Persons (AARP), appreciates the opportunity to present its views regarding the so-called Social Security notch. The issue remains a controversial one.

Unfortunately, because of misinformation about the intent and impact of the 1977 Social Security Amendments, many persons born between 1917 and 1921 believe they are being discriminated against. They contend their Social Security benefits have been reduced unfairly, and they petition Congress for a change. They also have called upon AARP to revise its current policy. Despite their persistent efforts, the Association, along with the overwhelming majority of organizations representing older persons, maintains that Congress acted responsibly and appropriately in 1977 when it changed the overly generous Social Security benefit formula adopted in 1972.

Furthermore, the Association believes that legislation to change current law is not needed. Those born between 1917 and 1921 are not being cheated. They receive a fair benefit. Legislative proposals to raise benefits for those born between 1917 and 1921 represent a serious threat to the long-term integrity of the Social Security trust funds. Lacking a financing mechanism, these proposals would siphon off trust fund reserves which cushion today's retirees against an economic downturn and which also are accumulating in anticipation of the retirement of those born in the post-World War Two baby boom.

WHAT HAPPENED

In 1972, Congress increased Social Security benefits and provided an automatic, annual cost-of-living adjustment (COLA). Unfortunately, Congress made a serious error when it enacted a

benefit formula which overcompensated for inflation. The result was that those born between 1912 and 1916 received very high replacement rates, much higher than anyone had ever anticipated. Had that been allowed to continue, the Social Security system as a whole would have gone bankrupt and been unable to pay benefits to anyone. Even many of those born between 1917 and 1921 (the transition group) acknowledge the serious error Congress made in 1972.

Clearly, Congress had to take action to correct the 1972 error, and in 1977 it passed the Social Security Amendments. At that time, Congress had several choices: recoup benefits from those who had retired under the 1972 formula, raise payroll taxes to finance the costly mistake, or revise the benefit formula for subsequent retirees. Because it seemed unreasonable to take benefits from those already retired or burden current workers with increased payroll taxes, Congress chose to correct the benefit formula.

However, to cushion those who were about to retire and might have been expecting higher benefits, Congress decided to phase-in the new formula. While the House of Representatives and the Carter Administration, as well as AARP, supported a ten-year transition, Congress ultimately adopted a five-year transition period. Thus, those born between 1917 and 1921 had their benefits calculated under a special transition formula as well as under the "new" (1977) benefit formula. Those in the transition group are able to use either of the two benefit formulae, whichever results in higher benefits. The benefits for everyone born after 1921 are based only on the new formula.

Even with the wisdom of hindsight, it is unclear whether a longer transition would have substantially altered the effects of

the phase-in or the subsequent perceptions of injustice currently held by so-called "notch babies". Nonetheless, Congress clearly intended to change the formula and believed that five years was an adequate adjustment period.

Also, Social Security faced a major financing crisis in 1983. Without the 1977 benefit formula change, the impact on all beneficiaries of the 1983 Social Security Amendments would have been much more severe.

ARGUMENTS ABOUT THE NOTCH

Advocates of changing the transition formula cite various arguments. Widely mentioned is the notion that the 1917 to 1921 cohort receives less favorable treatment than beneficiaries who retired before and after them. According to General Accounting Office (GAO) and the National Academy of Social Insurance (NASI) reports, the transition group's benefits may be higher and certainly are not lower than those born after them. Undoubtedly those born between 1912 and 1916 received a higher replacement rate than all other beneficiaries, but that does not constitute an acceptable rationale for perpetuating a costly mistake that threatened the integrity of the trust funds.

Some born between 1917 and 1921 feel especially aggrieved because they insist on comparing dollar benefit amounts. A Social Security benefit is not a guarantee of a fixed dollar amount. Instead, it replaces a portion, or percentage, of a worker's earnings that he or she loses due to retirement, death, or disability.

Understandably people compare the amount of their checks. However, a worker's benefit amount is calculated on a number of factors including his or her level of earnings during a working

life, the person's work history, age at retirement, and year of birth. Given these and other variables it can be misleading to compare dollar benefits among different beneficiaries to support the claim of discrimination.

The transition beneficiaries are not being cheated; they receive an equitable replacement rate consistent with beneficiaries born before 1910 and those born after 1921. Only one small group of beneficiaries received a bonanza; the rest did not.

Recently, some have suggested that the perceived unfairness of the "notch" undermines confidence in Social Security. Public opinion surveys show that younger people are concerned about the future viability of the Social Security system and the ability of the system to pay adequate benefits when they retire. Support remains high, however, using trust fund reserves now to finance additional benefits for some retirees could deepen these already expressed concerns about the system's future financial soundness.

Finally, those who argue for additional benefits for the transition group claim that this would help economically vulnerable older persons. As the GAO and NASI reports conclude, those most likely to benefit from a change in the 1977 law are upper-income individuals. Those at the lower end of the income scale are likely to benefit very little, if at all, from a change.

WHO WILL PAY?

Changing current law could impose serious burdens on the trust fund and current workers. For example, if any expensive benefit expansion were enacted without new financing, then the

long-term integrity of the trust funds could be jeopardized. A small change in the 1977 Amendments would cost more than $20 billion over 10 years, a "moderate" change about $70 billion over the next decade and a more substantial change over $300 billion. Money taken from the trust funds for additional benefits now means that there will be less money available to help pay benefits in the future to today's workers.

On the other hand, the trust funds could be made whole by raising the payroll taxes on workers. The 1983 Social Security Amendments provided for two payroll tax increases in 1988 and 1990. They were part of a carefully crafted package in which current retirees and today's workers agreed to make sacrifices for the long-term soundness of the system. As the GAO says "imposing additional taxes on these current workers to finance a higher replacement rate for the notch group (many of which already receive a higher replacement rate than can be anticipated by current workers) would raise significant issues of equity."

CONCLUSION

AARP continues to believe that we cannot sacrifice the interest of future retirees to meet the unreasonable demands of some current retirees. As Senator Pepper says to his constituents who seek to change current law, "Because I would like nothing better than to raise the level of benefits for all of America's senior citizens if it were within our means to do so, I hope you will understand it saddens me deeply to have to hold my position that the Notch is not the problem. It is the result of correcting a problem that posed a serious threat to Social Security."

The actions Congress took in 1977 were necessary. Social Security is a program that affects all Americans -- workers, retirees, the disabled and their families. To focus on the unwarranted demands of one small group of beneficiaries could threaten the fiscal soundness of Social Security, thereby affecting everyone.

STATEMENT OF SENATOR RICHARD G. LUGAR

Subcommittee on Social Security Hearing on the Notch

January 23, 1989

I am pleased that the Subcommittee on Social Security has acted so early in the 101st Congress to schedule hearings on the notch problem. I was among the Senators who urged Senator Bentsen to hold such hearings last year.

The reform in the Social Security benefits formula which created this "notch" was a needed correction which literally saved the program from going bankrupt. But the correction also created a serious problem. It created an obvious inequity in the treatment of individuals who have made similar contributions to the Social Security program under similar conditions.

Notch victims have been waiting for years for a correction of this inequity caused by a costly mistake made in 1972 when Congress calculated a new formula for Social Security cost-of-living adjustments. The mistake, which accidentally indexed increased benefits twice for inflation, would have bankrupt the system eventually. In 1977 Congress fixed its error, but did not take back the over-indexed benefits from those who had already retired and begun relying on this higher income. To ease the adjustment to the lower benefits formula that was necessary to preserve the system, Congress gradually realigned the benefits for retirees born between 1917 and 1921.

Although the transition formula is arguably fair in terms of benefits received versus contributions made, the drop in dollars compared to earlier retirees has been drastic. It is hard to explain why it is fair for persons who have worked under similar conditions and made similar contributions through life should accept lower benefits than retirees who preceeded them by a year or two.

It was my privilege to be the first cosponsor of Senator Sanford's proposal, one which most now consider the primary vehicle addressing the notch issue. The bill will establish a more gradual phasing-in period that will avoid the present disparities. If the proposal becomes law, the benefit level for "notch babies" will be raised. Persons retiring in the 1980's will be protected by a longer transition period, and current retirees will be provided with a modest retroactive benefit for past periods of entitlement at depressed levels. But it will continue to allow the Social Security trust funds to build-up for the future. In fact, should the bill pass as it is currently drafted it will permit the trust funds to exceed $1.2 trillion by the end of the century.

Opponents of the bill say it would take too much out of the Social Security trust fund. We all realize that a surplus must be saved now to have enough money on hand when the "baby boomers" generation retires. But the bill preserves an average annual build-up of $58.9 billion over the next ten years. Indeed, the real cost of the legislation would simply be a postponement of less than one year of the current rate of build-up in the trust fund.

I believe the measure represents a fair and careful adjustment which does not threaten the future stability of the Social Security program. It would even out the notch -- making the necessary adjustment more gradually while also saving the Social Security Trust Fund from bankruptcy. It is a solution that will lessen the disparity between payments while preserving the system for future generations.

We must ensure that the Social Security system is fair and reliable and that the benefits will be there when we need them and in the future when our children will need them.

Opening Statement by
Senator Daniel Patrick Moynihan
Chairman

This is an oversight hearing of the subcommittee concerning the Social Security benefit Notch, as it has come to be called.

This is a matter that has attracted considerable attention in recent years, and is deserving of the most careful, compassionate and nonpartisan enquiry.

With this in mind, on March 7, 1988 Senator Bob Dole, the distinguished Ranking Minority Member of our subcommittee (and of course Republican Leader of the Senate) and I wrote to the newly established National Academy of Social Insurance to ask if they might conduct such an enquiry. The Academy promptly agreed, and the following November 14 Alicia H. Munnell, President of the Academy, sent us their report. The 100th Congress had, of course, adjourned sine die at that point. Senator Dole and I, with the cordial cooperation of Senator Bentsen, chairman of the full committee, arranged a hearing to be held on the first day of normal business of the 101st Congress, in order that we might hear from the Academy, and from other interested parties.

We are much indebted to the Academy, most especially to its learned study panel, headed by Robert J. Myers. All students of Social Security are students of his; all Americans are indebted to him.

This is the first occasion which the committee has had to call upon the Academy; thus begins what will surely prove a long and fruitful relationship.

There is, or ought to be, a rule of sorts in these matters. Everyone is entitled to his own opinion, but not his own facts.

We asked the Academy for facts, and now we have them.

By a happy circumstance, unbeknownst to us at the time, just as the Senate was commissioning a study of the Notch, the House was receiving one. Our distinguished friend and colleague the Honorable Andy Jacobs, Jr., Chairman of the Subcommittee on Social Security of the House Committee on Ways and Means, received a report from the Comptroller General. The GAO report was submitted on March 24, not three weeks after our request was made.

We take it to be of considerable importance that the two reports, somewhat different in their modes of analysis, are identical in their conclusions. It will be our special pleasure this morning to have with us Mr. Joseph Delfico, the learned and thoughtful author of the GAO report, who will relate their conclusion.

I could scarcely not be aware that the conclusion of the two reports will disappoint some. This is understandable. A situation has arisen which <u>seems</u> unfair. It is not. No retired person is receiving <u>less</u> in Social Security benefits than Congress intended. Some are receiving <u>more</u>. Well, that happened. Nobody planned it; certainly not the beneficiaries.

There is a larger consideration here which we should perhaps bear more in mind than we seem to do.

For the present generation of retired American workers, Social Security is a truly generous system. It is not easy to compute the portion of Social Security benefits which can be attributed to Social Security contributions. This is to say, what would the accumulated old-age and survivors insurance tax payments by a statistically average worker and his employer actually "buy" in the way of survivors insurance and retirement benefits? The estimates I have heard suggest that current retirees have paid in less than 15 percent of what they will get back in benefits.

This is to say that 85 percent or more of Social Security benefits for current retirees is, in effect, a transfer payment. There is nothing unusual in this. To the best of my knowledge most social insurance systems -- around the world that is -- provide this "windfall" for early members. And clearly, this cannot go on indefinitely. Not too long into the next century things will have to even out for government sponsored insurance and annuities, just as they must do now in the private sector. But the present situation is worth keeping in mind.

Finally, may I note that Senator Dole regrets that a long engagement keeps him out of the city today. I have here a statement by him which I would now place in the record.

STATEMENT

BY

DORCAS R. HARDY

COMMISSIONER OF SOCIAL SECURITY

HEARING ON THE "NOTCH"

FEBRUARY 21, 1989

Mr. Chairman, members of the committee:

I appreciate the opportunity to present this testimony to your committee in connection with your consideration of the "notch." One of my highest priorities is to educate the public about Social Security, and the notch issue warrants a complete explanation. I appreciate this opportunity to clarify the history of the notch issue.

First, though, I would like to commend Chairman Moynihan and Senator Dole for requesting the excellent study recently completed by the nonpartisan National Academy of Social Insurance. The Academy has made a major contribution which should promote public understanding of this complex issue and provide a nonpartisan background against which policymakers can discuss the issue.

Introduction

The notch has been defined in different ways by different people. Generally, however, it refers to the difference in benefits payable to workers born after 1916, who have their benefits computed under the new and more equitable computation method enacted in 1977 and benefits payable to workers with similar earnings histories born between 1910 and 1916, who have their benefits computed under a flawed computation method enacted in 1972. In particular, some beneficiaries born in 1917-21 believe that they are treated unfairly compared to those born in 1916 and earlier.

In actuality, the notch occurs because workers born between 1910 and 1916 receive unintended windfall benefits. They receive these windfall benefits because of the flawed 1972 benefit computation method which overcompensated for inflation and allowed for inequitable wage replacement ratios. This method was corrected by the 1977 amendments, and all workers born after 1916 have their benefits computed under the new and more equitable method.

No inequity has occurred with regard to those people born in 1917 and later. They are receiving appropriate benefit levels that were intended by Congress and that compare favorably to benefit levels for people born prior to 1910, who did not profit from the unintended windfall caused by the flawed 1972 computation method. All of the bills that were introduced in the 100th Congress to deal with the notch would have extended the unintended windfall benefits to more groups of beneficiaries and would have cost from $24 billion to $375 billion over the first 10 years.

The financial soundness of the Social Security trust funds rests on the policies developed by the bipartisan National Commission on Social Security Reform and enacted in the Social Security Amendments of 1983. The Commission unanimously recommended that Congress "not alter the fundamental structure of the Social Security program or undermine its fundamental principles." Due to the policies adopted by the Commission, the Social Security trust funds are continuing to grow. The assets that will be accumulated are not a surplus, but rather an essential reserve to meet the program's benefit obligations as the "baby boom" generation retires.

Effects of 1972 Legislation

A review of the major events that led to the current notch situation is appropriate. In 1972, in order to maintain the purchasing power of Social Security benefits after a worker retires, Congress provided for automatic cost-of-living adjustments (COLAs) beginning in 1975. However, the computation method in the 1972 legislation was flawed. It overadjusted the benefits of workers retiring in the future for increases in the cost of living.

This overadjustment occurred for two reasons. First, cost-of-living increases that were meant for retired workers were also incorrectly built into the future benefits of workers who had not yet retired. Second, workers' wage increases also generally reflect cost-of-living increases. The flawed benefit calculation took into account increases in both wages and prices. Thus, during a person's working years, his or her future benefits were increased more than necessary to reflect increases in the cost of living.

This overadjustment of benefits, combined with the very high inflation of the 1970's, resulted in unanticipated increases in overall benefit levels. Benefits for people initially affected by the flawed computation method--generally those born in 1910 and later--increased dramatically. It was projected that benefits for many workers retiring in the future would substantially exceed their preretirement earnings.

The dramatic increase in benefits under the flawed benefit computation method caused an increase in program costs. This increase in costs, combined with the adverse economic conditions of high inflation, high unemployment, and sluggish wage growth that were encountered during the 1970's, caused the annual outgo from the Social Security trust funds to exceed annual income. Thus, the overadjustment of benefits for inflation was a major factor in the projected long-term deficit and was expected to have a significant impact on trust fund balances by the mid-1980's.

Beginning in 1975, Congress, the Administration, and the 1975 Advisory Council on Social Security gave intense consideration to fixing the flaw in the 1972 legislation. As a result of 3 years of exhaustive study, in 1977, Congress enacted a major revision of the Social Security benefit structure which was designed to put a stop to runaway benefits, restore more appropriate benefit rates, and help solve the financing problems facing Social Security at that time.

This new and more equitable 1977 computation method applies to all workers born in 1917 and later. It provides for indexing a worker's lifetime wages to keep them up to date with average wage increases. It also keeps benefits up to date with the cost of living by providing COLAs once the person reaches age 62. Under this method, replacement rates--benefits expressed as a

percent of preretirement earnings--were stabilized. This means that over time workers with similar earnings histories will generally receive Social Security benefits that replace the same percent of their preretirement earnings, regardless of the pattern of increases in wages and prices in the economy. Thus, the problem of ever increasing replacement rates caused by the flaw in the 1972 computation method will not recur.

Effects of 1977 Legislation

In addition to revising the flawed computation method in 1977, Congress made a number of related changes. First, replacement rates under the new computation method were deliberately set approximately 5 percent lower for age-62 retirees than the rates that were expected to occur under prior law in January 1979. This change was made in order to eliminate some of the unintended rise that had occurred under the old computation method. However, inflation after enactment of the 1977 amendments was higher than had been expected, causing replacement rates under the old computation method to rise more rapidly than had been anticipated. As a result, when the new computation method went into effect in 1979, the reduction in replacement rates at age 62 was about 7 percent, rather than 5 percent.

Second, people born before 1917 were allowed to continue to receive benefits under the old, flawed computation method that overcompensates for inflation. This was done because Congress wished to avoid reducing benefits for people already receiving them. However, it has the effect of increasing the difference in benefit amounts under the old and new methods.

Third, Congress provided a transitional computation method for workers born in 1917-21. It was designed to give some protection to workers who reached age 62 and retired just after the new computation method became effective. This group was most likely to have made retirement plans based on the benefit levels under old law.

Thus, the benefit levels provided under the 1977 legislation were both intended and appropriate. Benefits under the new method compare favorably with the level of benefits for people who reached age 62 before the unintended rise occurred in the 1970's, that is, people born before about 1910. Replacement rates for workers receiving benefits under the new computation provisions also are generally as high as, or higher than, replacement rates for comparable workers who retired in the early or mid-1970's before the unintended rise occurred.

The true situation is that people born in 1910-16, who receive benefits computed under the pre-1977 method, are receiving windfall benefits because that computation method overcompensated for inflation. What the beneficiaries born after 1916 want is the same unintended windfalls that those born in 1910-16 are getting.

Impact of Economic Conditions after 1977 on Replacement Rates

As I noted previously, economic experience after 1977 had a major impact on the growth in replacement rates, and actual experience in the years immediately following enactment of the 1977 amendments varied from what was anticipated at the time of enactment. Under the economic conditions expected in 1977, it was anticipated that replacement rates under old law would continue to rise gradually, while replacement rates under the new law were expected to stabilize in the near term at levels somewhat lower than anticipated to prevail under old law in 1979.

However, the rapid inflation after 1977, combined with the decline in real earnings in some years, caused replacement rates for workers whose benefits were computed under the flawed 1972 computation method to increase to levels much higher than either intended or expected. While the high inflation after 1977 also resulted in replacement rates being higher than anticipated during the early years of the 5-year transition, replacement rates stabilized at approximately the level that Congress intended when the 1977 amendments were passed. Thus, it appears that congressional intent has been fulfilled.

I would like to emphasize that the reason the difference between benefits under old and new law was somewhat larger than anticipated was not because people subject to the new computation method got less than had been intended. Rather, it was because people who had their benefits computed under the old method were getting much more than anyone had anticipated due to economic conditions.

Explanation of Attached Charts

Attached to my testimony are four charts that illustrate the treatment of workers who have their benefits computed under old and new computation methods by comparing replacement rates (initial benefits as a percent of preretirement earnings) and benefits for workers who retire at age 65 and who always had average earnings. I hope that these charts will help to clarify the points that I have been making.

I would like to emphasize that these charts are illustrative only. Most workers do not have such regular earnings patterns and actual benefits and replacement rates will vary accordingly. However, the basic principles illustrated by the charts will hold true, regardless of actual earnings patterns.

These charts show clearly that the problem we are dealing with is not so much a sudden decrease in benefits for people under the new law, but, rather, a steep increase in benefits for the workers who had their benefits figured under the flawed 1972 computation method.

Chart 1 illustrates replacement rates for workers with average earnings retiring at age 65 as they were anticipated in 1977 with and without enactment of the 1977 benefit formula. This chart shows that:

- Without the amendments, replacement rates were anticipated to continue to rise gradually to about 53 percent by the turn of the century.

- It was also anticipated that under the amendments replacement rates would decline from 47 percent to 42 percent and would then stabilize at that level.

Chart 2 shows what really happened to replacement rates. Actual experience is overlayed on the first chart so a comparison can be made between the anticipated and actual results of the 1977 legislation. This chart shows that:

- Replacement rates soared under the old law because of economic conditions, reaching a high of 54 percent. If old law had remained in effect, it is now estimated that replacement rates would have continued to climb to 66 percent by the year 2000.

- Replacement rates under the amendments were initially higher than expected because of economic conditions. However, replacement rates stabilized at approximately the same level

as was estimated in 1977. Thus, over the long term congressional intent was fulfilled despite the impact of unanticipated economic conditions.

Chart 3, which illustrates benefits in terms of replacement rates shows:

- A steep increase in replacement rates for workers born just before 1917. This group is the windfall group.
- Somewhat lower replacement rates for workers born just after 1916 than for the windfall group.
- Replacement rates for the group born just after 1916 that are as high as, or higher than, any other group of similar retirees except the windfall group.
- Replacement rates through the year 2000 that stabilize at about 41 percent. Thus, a worker who generally has average earnings can expect Social Security benefits to replace about 41 percent of the earnings he or she has in the year before retirement.

Chart 4, which illustrates benefits in terms of 1989 dollars, shows that:

- Workers born in the 1917-21 period--frequently characterized as the notch years--receive benefits that are higher than any group born before them except for workers born in the 1910-16 period who profited from the flawed 1972 computation method.
- Workers retiring in the future are projected to receive increasingly higher benefits even though these benefits still replace only 41 percent of the last year's earnings.
  - -- The increase is a direct effect of the new indexed computation method and the economic assumption that wages will increase faster than prices in the future.
  - -- Since people retiring in the future are assumed to have earned higher wages, the amount of their benefits will be higher.

You can also see from these charts that any proposal that would increase benefits for workers born after 1916 would simply extend the unintended windfall benefits to new groups of Social Security beneficiaries. The cost of such an extension would have to be borne by current and future workers.

Recent Independent Studies on the Notch

As I mentioned earlier, the National Academy of Social Insurance has recently studied and reported on the notch issue. The findings of the Academy report are consistent with our views of the notch issue that I have outlined for you here today. The Academy recommended that no change should be made to current law for purposes of dealing with the notch. Specifically, the Academy found that:

- The notch arises because workers born in 1911-16 are receiving an unintended "windfall" -- not because those in the notch group receive "too little."
- Workers born in 1917-21 are not really disadvantaged relative to those born in 1922 or later. The differences in the benefit computation procedures applicable to those born in

1917-21 and those born later generally result in higher replacement rates for workers born in 1917-21.

- The benefits for people born in 1917 and later are at about the level that Congress intended, whereas the benefits paid to those persons born in 1911-16--especially those who worked beyond age 62--are higher than Congress believed desirable.

- The panel concluded that there is no reasonable basis for eliminating the notch by increasing the benefits of people born in 1917 and later, nor is it reasonable to reduce benefits for persons already receiving them.

In addition, the General Accounting Office (GAO) issued an extensive report on the notch issue early last spring that concluded that the 1977 Social Security amendments had stabilized benefit rates, as Congress intended, and any legislation on the notch would be costly and could be difficult to implement.

Conclusion

In summary:

- Some workers born between 1910 and 1916 receive windfall benefits as a result of a flaw in the 1972 computation method.

- No inequity has occurred with respect to workers born after 1916. All workers born after 1916 receive appropriate benefits. These benefits are at the level that Congress intended when they passed the 1977 legislation which corrected the flaw in the 1972 computation method.

- Consistent with the recommendations of the bipartisan Commission, the trust fund assets are currently accumulating. And these assets are an essential reserve needed to pay future retirees. There is no surplus in the trust fund reserves to pay for extending the windfall benefits received by the 1910-16 group to additional workers.

Attachments

Growth in Social Security Replacement Rates for Average Earners Retiring at Age 65, as Anticipated in 1977

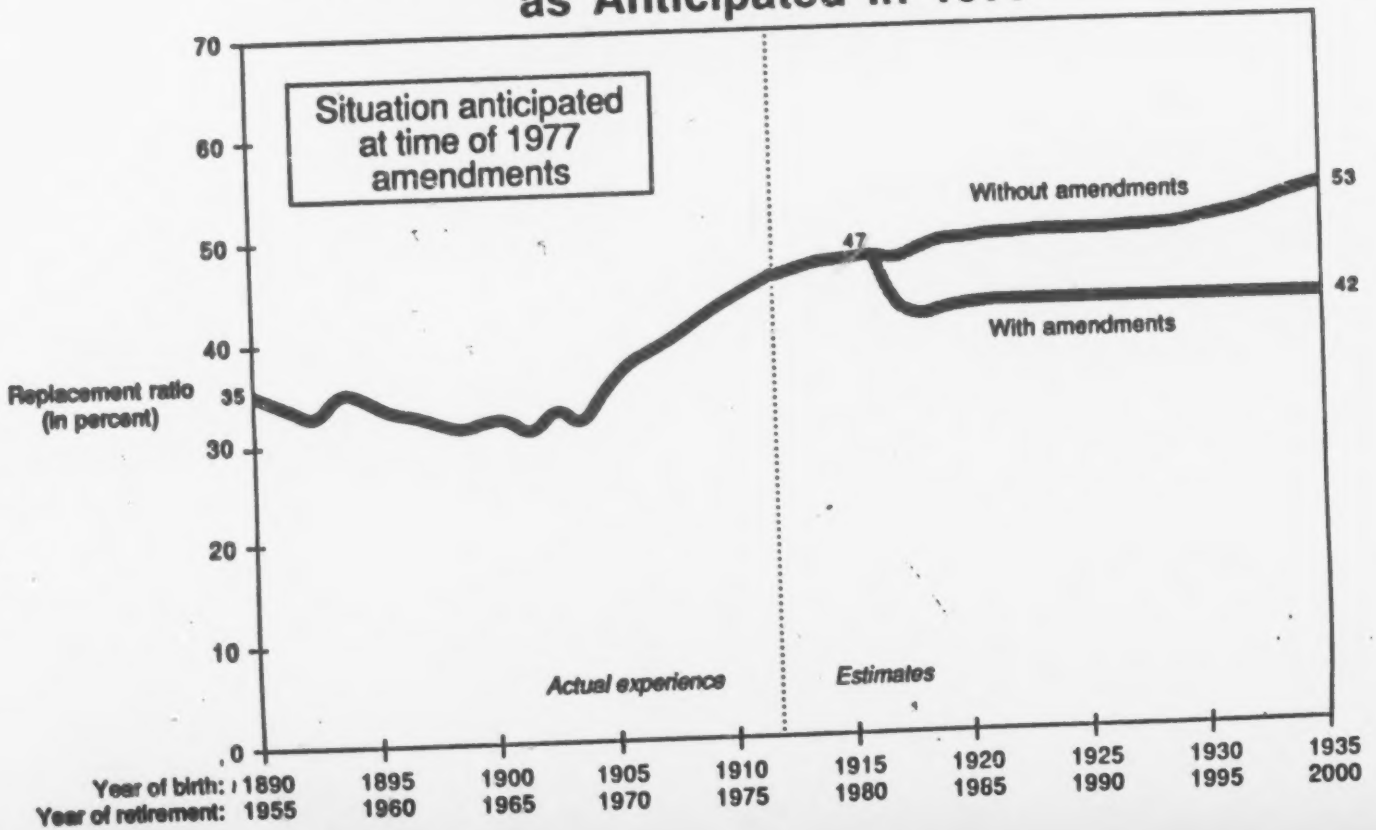

CHART 1

Anticipated vs. Actual Growth in Replacement Rates for Average Earners Retiring at Age 65, and Effects of 1977 Amendments

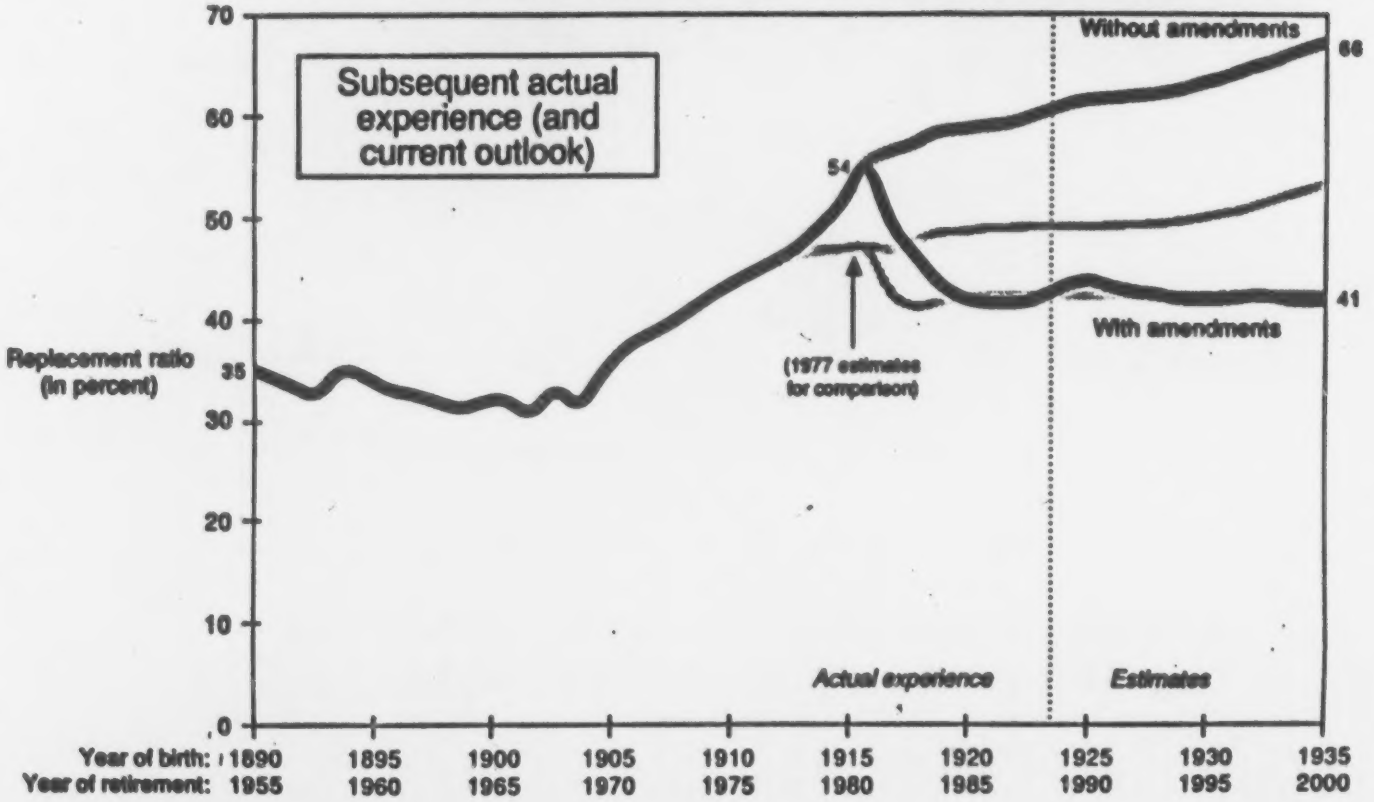

CHART 2

Social Security Replacement Rates for Age-65 Retirees with Average Earnings

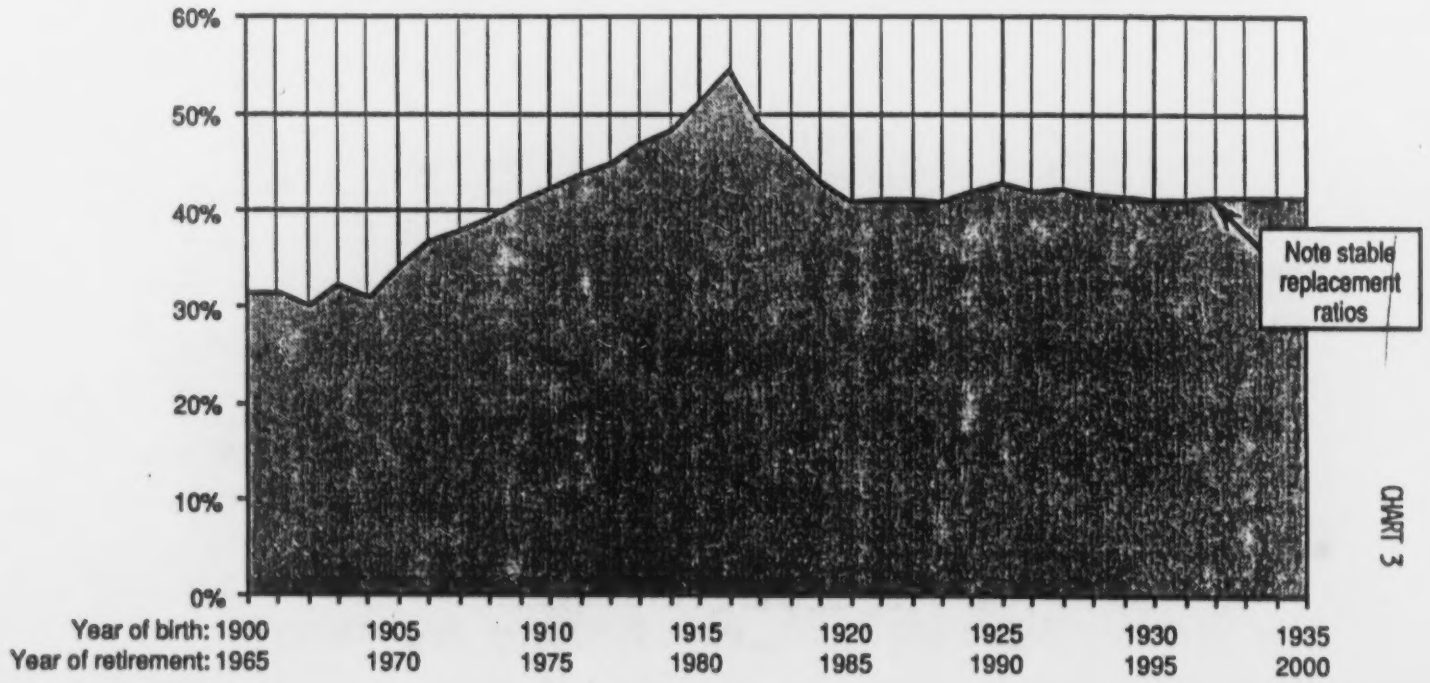

CHART 3

Social Security Benefits (in 1989 Dollars) for Age-65 Retirees with Average Earnings

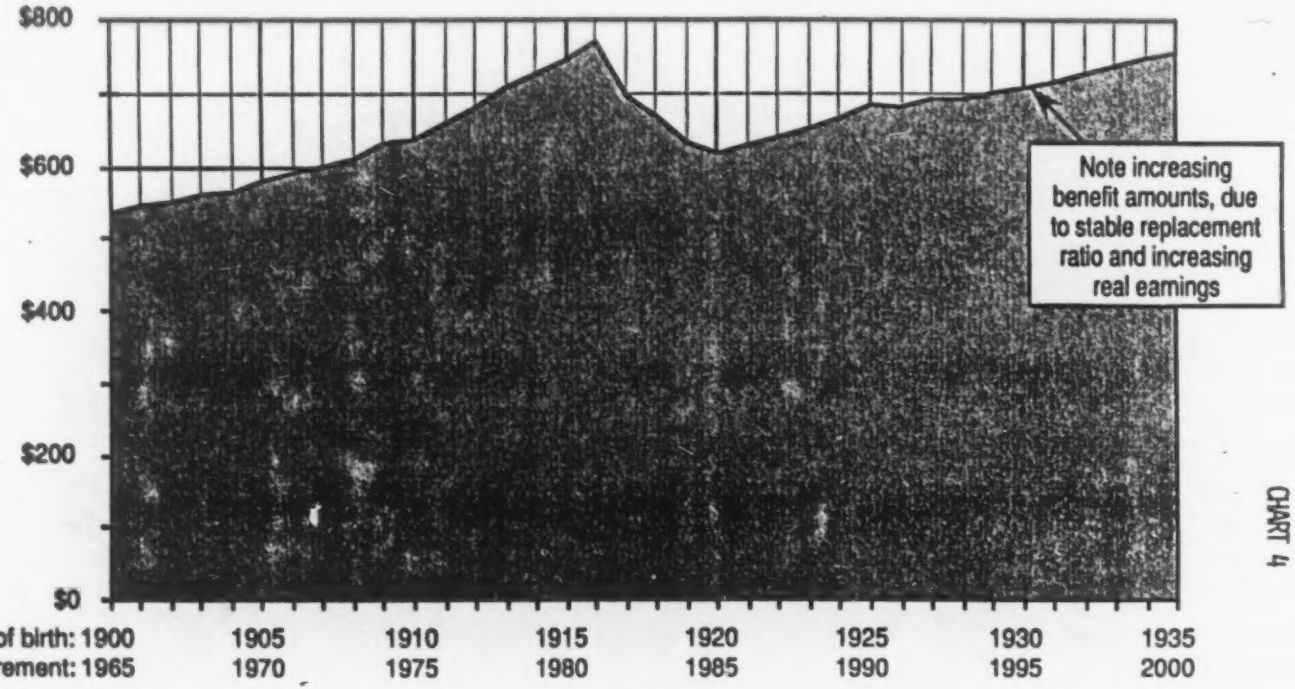
$800
$600
$400
$200
$0
Note increasing benefit amounts, due to stable replacement ratio and increasing real earnings
Year of birth: 1900 1905 1910 1915 1920 1925 1930 1935
Year of retirement: 1965 1970 1975 1980 1985 1990 1995 2000

CHART 4

STATEMENT BY ROBERT J. MYERS BEFORE THE SUBCOMMITTEE ON SOCIAL SECURITY AND FAMILY POLICY, COMMITTEE ON FINANCE, UNITED STATES SENATE, WITH REGARD TO THE SOCIAL SECURITY BENEFIT NOTCH ISSUE, JANUARY 23, 1989.

Mr. Chairman and Members of the Subcommittee: My name is Robert J. Myers. I served in various actuarial capacities with the Social Security Administration and its predecessor agencies during 1934-70, being Chief Actuary for the last 23 of those years. In 1981-82, I was Deputy Commissioner of Social Security, and in 1982-83, I was Executive Director of the National Commission on Social Security Reform.

I am testifying today in my capacity as Chair of a Study Panel established by the National Academy of Social Insurance to examine the issue of the so-called Social Security benefit notch. Chairman Moynihan and Senator Dole had requested the National Academy to make such a study, which was completed and published last November.

The National Academy of Social Insurance is a nonprofit, nonpartisan organization devoted to furthering knowledge and understanding of Social Security and related programs. The National Academy takes responsibility for assuring the independence of any panel formed under its auspices.

Penel members are selected for their recognized expertise and with due consideration for the balance of disciplines appropriate to the project. The resulting report is the responsibility of the panel members, but in accordance with the procedures of the National Academy, it has been reviewed by a committee of its Board for completeness, accuracy, clarity, and objectivity.

The panel consisted of the following persons in addition to myself: Gary Burtless, Senior Fellow in the Economic Studies program, The Brookings Institution; Suzanne B. Dilk, formerly Analyst, Social Security Administration and the National Commission on Social Security Reform; and James W. Kelley, Attorney at Law, formerly Staff Director, Subcommittee on Social Security, House Committee on Ways and Means.

Now, let me illustrate the analysis and the findings of our Study Panel by discussing several charts and tables.

Chart 1 shows the current monthly benefits for persons born in various years who had average earnings histories and retired at age 65, including a projection in current dollars for those who will retire in the next decade.

If one were to look at only the right-hand section of the chart -- i.e., those born in about 1910 or later, it would appear that the trough for those born in 1917-21 -- the so-called "notch" group -- indicates unduly low benefits. However, when one looks at the broader picture, a basic characteristic of the program is evident -- namely, at any given time, the benefit for a particular retirement age and earnings history rises as the year of birth increases. This is due to the underlying policy of maintaining constant replacement rates as of time of retirement and then keeping the benefit up to date with changes in the price level, which tends to rise somewhat less rapidly than the wage level.

Thus, the sharply rising benefit amounts for those born in 1912-16, which were due to the faulty benefit-computation method adopted in the 1972 legislation, gave bonanzas to this group. The benefits for those born in 1917 and later are well in accordance with the long-time trend for those born before 1910. In fact, the benefits for births in 1917-19 are somewhat higher than the expected trend. This chart clearly shows that those born after 1916 receive equitable treatment as compared with those born later and with those born before 1910. It could just as well be argued that the latter group are now being treated unfairly, because their benefits are lower than those for persons born after 1916.

The proper way to consider whether equitable benefits are being paid is to examine replacement rates, as is done in Chart 2. Such rates are very stable for those born in 1919 and later. However, a significant peak occurs for those born in 1916, with somewhat lower rates for the surrounding years of birth. Again, this portrays the effect of the faulty benefit-computation method adopted in 1972. Those born after 1916 -- say, in 1917 and 1918 -- are treated relatively more favorably than those born in later years, which is the result of the transitional-guarantee provision contained in the 1977 legislation in order to have some phase-in of the new, correct benefit-computation method.

Chart 3 examines the matter from another angle by considering replacement rates for men retiring alternatively at age 62 and at age 65 in various past years. The age-65 figures are the same as in Chart 2, with a peak in the rates for those born in 1916 and retiring in 1981 and with the proper, lower and stable rates for those bon in 1920 and later -- with such rates being significantly higher than for similar persons who retired before 1975.

When we look at the age-62 figures in Chart 3, a very important point is apparent. The replacement rates are stable for those retiring after 1974, so that no notch whatsoever arises. The important conclusion can be drawn that no benefit notch occurs for the very large proportion of persons who retired at age 62, regardless of whether they were born in 1917-21, or at some earlier or later time.

This same point is brought out in another way in Chart 4, which shows -- alternatively for workers with average wages and with maximum wages -- the benefits payable in 1988 as between persons born in late 1916 and persons born in early 1917 who retired on various past dates. This is the extreme case for the notch situation. The difference in the benefits of the two individuals is relatively negligible when retirement occurs in January 1979, upon attainment of age 62. As the date of retirement becomes later, the difference becomes larger and larger, reaching almost $150 for the average wage earner and $200 for the maximum wage earner when retirement is at age 68 or above. Thus, the notch -- or, perhaps better said, the windfall for workers born in the few years before 1917 occurs only when they have substantial employment beyond age 62.

It is sometimes said that those born in 1917-21 are treated inequitably as compared with those born in later years. That this is not so is shown by Chart 5, which compares the benefits for persons born in late 1921 and persons born in early 1922 who have the same earnings record and retire on the same date. As can be seen, the differences in the benefits between these two persons are negligible.

Finally, Chart 6 shows the benefits that would have been paid to persons born late in 1916 who retire at various dates if the proper procedure had been adopted in the 1977 legislation with regard to their earnings after 1978. Such procedure would have been to compute benefits on such earnings in the same manner as is followed for persons who attain age 62 after 1978 -- namely, to use the Average Indexed Monthly Earnings method of computations for them. As can be seen, the differences in the benefits that would have been paid to these persons born in late 1916 under this correct procedure would have differed only slightly from the benefits actually paid to similar persons born in early 1917 -- and thus no significant notch would have occurred. Chart 6 also shows the benefits actually payable to those born in late 1916 for various dates of retirement -- the

figures in parentheses. The difference between these actual benefits and what would have been payable if the proper procedure had been followed represents the windfall (or bonanza) for persons born shortly before 1917 who worked well beyond age 62 after 1978.

In summary, the real problem with regard to this matter is that those persons who were born before 1917 who worked well beyond age 62 after 1978 receive undue windfalls. Those born after 1916 are equitably treated, consistent with the intent of Congress, and receive proper benefit amounts (which, incidentally, are far more than the amounts "actuarially purchased"). There is no reason why younger workers should, over the years, pay more taxes to provide windfall benefits to this group. Conversely, although there is a case for reducing (gradually or otherwise) the windfall benefits for some persons born before 1917, this would not now be equitable. The panel therefore recommends that Congress take no legislative action on the notch benefit issue.

REPORT OF THE NATIONAL ACADEMY ON SOCIAL INSURANCE

LETTER OF TRANSMITTAL

NATIONAL ACADEMY OF SOCIAL INSURANCE

November 14, 1988

Senator Daniel Patrick Moynihan, *Chairman,*
Subcommittee on Social Security and Family Policy,
Committee on Finance,
U.S. Senate,
Washington, DC 20510

DEAR MR. CHAIRMAN:

I am pleased to present to the Subcommittee on Social Security and Family Policy of the Senate Committee on Finance a report undertaken by the National Academy of Social Insurance on the Social Security benefit "notch" at the request of Senator Dole and yourself in your letter of March 7.

We shall be glad to discuss this report in greater detail with you and members of your staff.

Sincerely,

ALICIA H. MUNNELL,
President

LETTER OF TRANSMITTAL

NATIONAL ACADEMY OF SOCIAL INSURANCE

November 14, 1988

Senator Bob Dole, Ranking Minority Member,
Subcommittee on Social Security and Family Policy,
Committee on Finance,
U.S. Senate,
Washington, DC 20510

DEAR SENATOR DOLE:

I am pleased to present to the Subcommittee on Social Security and Family Policy of the Senate Committee on Finance a report undertaken by the National Academy of Social Insurance on the Social Security benefit "notch" at the request of Senator Moynihan and yourself in your letter of March 7.

We shall be glad to discuss this report in greater detail with you and members of your staff.

Sincerely,

ALICIA H. MUNNELL,
President

The National Academy of Social Insurance is a nonprofit, nonpartisan organization devoted to furthering knowledge and understanding of Social Security and related programs. The National Academy takes responsibility for assuring the independence of any panel formed under its auspices.

Panel members are selected for their recognized expertise and with due consideration for the balance of disciplines appropriate to the project. The resulting report is the responsibility of the panel members, but in accordance with the procedures of the National Academy, it has been reviewed by a committee of the Board for completeness, accuracy, clarity and objectivity.

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THE SOCIAL SECURITY BENEFIT NOTCH: A STUDY

I. INTRODUCTION

In 1977, the Congress enacted a new method for computing Social Security benefits applicable to persons first becoming eligible for retirement benefits on or after January 1, 1979. Essentially, insured workers attaining age 62 before the effective date were to have their benefits computed under the old system, whereas those attaining age 62 after that date were to be under the new system. The Social Security Amendments of 1977 included special transition provisions that applied only to workers who attained age 62 in 1979–83.

Shortly after the new system took effect, it became clear that the differences between the benefit amounts computed under the new procedures as compared to those computed under the old procedures were larger than had been expected. In particular, sharp differences could arise between two workers who had similar work histories but who differed mainly in that one was born in 1916 and became age 62 before January 1979, whereas the other was born in 1917 and became age 62 on or after January 1, 1979. For example, a worker who had earned in each year the maximum amount creditable for benefits and who retired at age 65 could receive about $100 a month less if born after January 1, 1917 than if born in 1916.

The pattern under which persons reaching age 62 in 1979 and thereafter have lower benefits than similarly situated older persons has become known as the "the notch." And the people who attained age 62 in 1979 and thereafter are known as the "notch group". Some of them believe incorrectly that the lower benefits are applicable only to insured workers reaching age 62 in the 1979–83 period, and believe that the notch issue is a question of inequitable treatment in comparison with those who attain age 62 later, as well as with those who have done so before. Other persons are simply concerned about the fact that their benefits are lower than are those paid to similarly situated older workers.

A number of legislative changes have been proposed to deal with the notch benefit disparity. Most of these changes involve increasing the benefits paid to at least some of the people reaching age 62 in or after 1979. Generally, these proposals require large expenditures from the Social Security trust funds.

The notch situation is undesirable and unfortunate. Naturally, it seems unfair to those born in the years shortly after 1916. However, careful and thorough analysis shows that the problem is really largely attributable to the fact that those born in the several years before 1917 who worked well beyond age 62 (after 1978) received

benefits which are too large and that it would be unwise to extend this over-generous treatment to additional persons.

Senator Daniel Patrick Moynihan, Chairman of the Subcommittee on Social Security and Family Policy of the Senate Finance Committee and Senator Bob Dole, the ranking minority member of that subcommittee, asked the National Academy of Social Insurance (see Appendix B for a description of the purposes and organization of the National Academy) to examine the "notch" question. (See Appendix A for the letter requesting the study.)

This report has been prepared in response to that request. It was developed by a panel of experts appointed by the Academy. The panel consists of the following persons: Robert J. Myers, Chair, formerly Chief Actuary, Social Security Administration and Executive Director, National Commission on Social Security Reform; Gary Burtless, Senior Fellow in the Economic Studies program, The Brookings Institution; Suzanne B. Dilk, formerly Senior Analyst, Social Security Administration and the National Commission on Social Security Reform; and James W. Kelley, Attorney at Law, formerly Staff Director, Subcommittee on Social Security, House Committee on Ways and Means.

In addition to an Introduction and Summary, the report consists of three sections: "Findings"; "Review of Pending Legislation and Views of Various Organizations"; and "Recommendation of the Panel", plus several Appendices. Appendix A contains the letter of request for the study. Appendix B is a statement of the purposes and organization of the National Academy of Social Insurance. Appendix C presents a bibliography of publications and documents on the "notch" subject; of special importance in the bibliography is the recent report of the General Accounting Office, which represents the results of its intensive, long-term study of the matter and contains extensive factual data. Appendix D describes the methods of benefit computation under the 1972 and 1977 Acts and also explains the flaw in the 1972-Act benefit-computation procedure that led to the need for change. Appendix E is a more technical analysis of some of the material appearing in the report. Appendix F gives the specifications for a method of benefit computation which would have prevented much of the "notch" had it been enacted in 1977. Appendix G compares various bills on the "notch" introduced in the 100th Congress.

The term "Social Security" as used in this report means the Old-Age, Survivors, and Disability Insurance program established by the Social Security Act. The term "notch", in general, denotes a significant difference in Social Security benefit amounts between two individuals who have the same earnings record, but slightly different dates of birth. This term can, however, also be used to refer to birth cohorts before and after a certain point in time which have significantly different benefit results for essentially similar earnings histories. Birth cohorts are defined as all persons born during a given time period. (Note that Social Security regulations provide that persons born on January 1 are considered to attain a particular age on the day preceding their birthday—i.e., in the previous calendar year—and this should be kept in mind when years of birth are referred to.)

The term "Normal Retirement Age" means the age at which unreduced benefits are payable (currently 65, but slowly increasing beginning in 2003, until it reaches 67 in 2027). The term "replacement rate" means, for a steady worker, the annual benefit initially payable for the worker alone, expressed as a percentage of the earnings in the previous year.

Examples used throughout the report demonstrate the effects of various provisions of law on purely hypothetical workers—one who has had earnings equal to the average earnings in the national economy in each year of her or his working lifetime and one who had earnings equal to or greater than the maximum annual amount counted for Social Security tax and benefit purposes each year. While these examples are useful for conceptual and illustrative purposes, they are not necessarily typical of individual workers under the program, relatively few of whom have annual wage increases precisely following national wage increases, and only a very small percentage of whom have earnings that consistently exceed the Social Security tax and benefit base.

This report has been prepared as part of the continuing studies of the Social Security program performed by the National Academy of Social Insurance. The views expressed in the report are those of the panel. In accord with the Academy's procedures, a subcommittee of the Board has reviewed the report from the standpoint of completeness, clarity, accuracy, and objectivity.

II. SUMMARY

The panel believes that one of its primary responsibilities in presenting this report is to reduce some of the widespread confusion surrounding this issue. Part of the confusion surrounding the "notch" issue arises from the complicated nature of the problem. However, part of the confusion is traceable to misleading (or even incorrect) information disseminated by groups which seek to increase Social Security benefits now paid to beneficiaries affected by the notch. This has resulted in deep misunderstanding of the issue by much of the general public, and even by some Members of Congress.

The panel considers the notch situation to be most undesirable and unfortunate. It naturally seems unfair to those born in the years shortly after 1916. However, careful and objective analysis shows that the problem is attributable to the fact that those born shortly before 1917 received benefits which were too large—especially if they worked well beyond age 62—and that it would be unwise to extend this over-generous treatment to additional persons.

The panel has concluded that the situation, being quite complex, has not been correctly understood by most people. The panel found that persons born in 1917–21 do not receive any lower benefits in relative terms than the Social Security program provides, by congressional intent, to those born after 1921. Persons born in 1917 or after receive Social Security benefits which are at the level relative to previous earnings that Congress determined desirable for future retirees under the Social Security program.

Some groups have been promoting legislation to raise benefits for those whom they believe to be adversely affected by the changes made in the Social Security Amendments of 1977. The panel concludes that this would not be fiscally responsible.

Under the various proposals to increase benefits for those in the notch group, one perceived inequity in the benefit structure would be eliminated, but another one would be created. Beneficiaries born in 1917–21 would then have substantially higher replacement rates than those born in later years. This inequity might, in turn, lead to calls to liberalize benefits for all those born after 1921. The cost of such increases could be very large and would jeopardize the financial stability of the trust funds for future generations unless contribution rates were raised substantially, an action which the panel believes would be completely unjustified for this purpose.

The findings of the panel are as follows:

1. Significantly larger retirement benefits are paid to some persons born before 1917 than to persons born in 1917 and after (the "notch group") who have similar earnings histories.

2. The differences in the benefit-computation procedures applicable to those born in 1917–21 and those born later are, if anything, generally to the advantage of those born prior to 1922 when benefits relative to prior earnings are considered. The 1917–21 group is not really disadvantaged relative to those born in 1922 or later.

3. Relative to pre-retirement earnings, benefits paid to those who were born in 1911–16 and who worked well beyond age 62 are higher than are benefits paid to those born either before or after that period.

4. The benefits paid to the notch group (those born in 1917 and thereafter) are at about the level that Congress intended for all future retirees, whereas the benefits paid to those persons born in 1911–16—especially those who worked well beyond age 62—are higher than Congress believed desirable.

5. The later the age at retirement, the greater the benefit difference or "notch"—because of the differences in the benefit-computation methods in the 1972 and 1977 Acts as they were affected by the economic conditions of the 1970s and early 1980s.

6. The "notch" arises because those born in 1911–16 are receiving an unintended "windfall"—not because those in the "notch group" receive "too little". It was inevitable that, if correction for replacement rates that were too high were made, birth cohorts following those who had been receiving excessive benefits would get less. The notch situation could have been reduced—and, in many cases, eliminated altogether—if, in 1977, Congress had adopted a provision that placed a cap on the windfall being received by workers born before 1917 who worked in 1979 and after.

7. Reducing the "notch" now by cutting the benefits of those receiving the unintended windfall would require reducing benefits for those already receiving them, who are counting on a continuation of the level of benefits awarded to them. Conversely, increasing the benefits of those born in the notch years would, in turn, create new relative notches affecting those born in later years (and also would increase the already unfavorable differential against those born in about 1910 or before).

The recommendation of the panel is as follows:

> Since the "notch" arises because the benefits of some of those born prior to 1917 are higher than was intended, there is no reasonable basis for reducing the "notch" by raising the benefits of those born later. Nor is it desirable to reduce the benefits of those already receiving them and counting on their continuation. Therefore, the panel recommends no change in present law that would either award additional benefits to those born after 1916 or reduce benefits for those born prior to 1917.

III. FINDINGS

1. Significantly larger retirement benefits are paid to some persons born before 1917 than to persons born in 1917 and after (the "notch group") who have similar earnings histories.

Persons born before 1917 who worked well beyond age 62 (in years after 1978) do receive substantially larger benefits than persons born in 1917 and after (actually, born on January 2, 1917 and after) who have similar earnings histories (i.e., also work well beyond age 62). This is truly a notch situation and naturally seems unfair to those born in the years shortly after 1916.

TABLE 1.—ILLUSTRATIVE CURRENT MONTHLY BENEFITS FOR MEN [1] WHO RETIRED AT AGE 65 WITH MAXIMUM OR AVERAGE CREDITABLE EARNINGS IN ALL PREVIOUS YEARS

Year of attainment of age	Year of birth	Maximum earners	Average earners
1972	1907	$653.30	$577.90
1973	1908	670.10	587.50
1974	1909	691.20	600.70
1975	1910	717.40	613.90
1976	1911	763.90	635.60
1977	1912	814.20	656.80
1978	1913	856.50	682.90
1979	1914	880.30	700.10
1980	1915	910.10	717.40
1981	1916	942.40	741.50
1982	1917	850.20	670.10
1983	1918	826.90	644.40
1984	1919	792.30	611.20
1985	1920	780.40	596.70
1986	1921	802.20	608.30
1987	1922	822.30	618.40
1988	1923	838.60	626.20

[1] Man attains the specified age at beginning of year and retires then. Figures for attainments of age 65 in 1978 and after are also applicable to women; for earlier years in the table, the figures for women are somewhat higher.

Table 1 illustrates this notch for people retiring at age 65 and for two earnings histories. As the table clearly shows, a person born in early 1917 as against one born in late 1916, both of whom have the same earnings record and are only a few days apart in age, will have significantly lower "current monthly benefits" (i.e., the benefits payable in early and mid-1988). However, the real question is whether this situation results from those born in 1917 and after being treated unfairly, or whether those born before 1917 are receiving "windfalls" or "bonanzas". Later sections of this report will examine this question in the light of what the Social Security program is supposed to do and what the Congressional intent has been. They will also examine the cause of this "notch" and the

policy question of whether anything should be done to reduce or eliminate the "notch".

2. The differences in the benefit-computation procedures applicable to those born in 1917–21 and those born later are, if anything, generally to the advantage of those born prior to 1922 when benefits relative to prior earnings are considered. The 1917–21 group is not really disadvantaged relative to those born in 1922 or later.

The "notch" problem is frequently presented as if those born in 1917–21 had a special disadvantage as compared to those born later. On the contrary, benefits for persons born after 1921 are, for similar circumstances, quite comparable and equitable relative to those for 1917–21 births. If anything, some of those born in 1917–21 have an advantage because they receive the larger amount resulting under two alternative benefit computation procedures (see Appendix D), whereas those born later can use only one of these procedures.

Table 2 examines the situation for persons born in late 1921 (the end of what some people consider the notch group) as against that for persons born shortly afterwards—in early 1922—for various dates of retirement and for two earnings levels. The differences in the initial benefits are negligible in all instances. This shows that those born in 1917–21 are not discriminated against when compared to those born after 1921.

TABLE 2.—ILLUSTRATIVE INITIAL MONTHLY BENEFITS FOR PERSONS BORN IN LATE 1921 AND EARLY 1922 WHO HAVE SAME EARNINGS RECORD AND RETIRE ON SAME DATE

Date of retirement	Average earners			Maximum earners		
	Born in 1921	Born in 1922	Difference	Born in 1921	Born in 1922	Difference
January 1984	$430	$437	$7	$556	$559	$3
January 1985	484	488	4	632	635	3
January 1986	541	544	3	713	715	2
January 1987	589	593	4	785	789	4

Some of the group born in 1917–21 does have the advantage of a transitional-guarantee computation provision that is not available to those born later. For some persons in this group, this provision had a significant effect by increasing their benefit amount. For example, the current benefit—i.e., the initial benefit, plus all cost-of-living adjustments—for maximum-earnings retirees at age 62 in 1979 would have been $633.80 except for the transitional-guarantee provision, which increased the monthly amount by $46.20, raising the benefit to $680.00 (see Appendix Table 3). For maximum earners attaining age 62 in 1980, the transitional-guarantee provision increased their initial benefits by $13.50 a month, from what would have been $627.30 to $640.80.

3. Relative to pre-retirement earnings, benefits paid to those who were born in 1911–16 and who worked well beyond age 62 are

higher than are benefits paid to those born either before or after that period.

Probably the best method of analyzing whether the benefits payable to those born after 1916 are inequitably low is to examine replacement rates—that is benefits as a percentage of recent earnings—for different ages at retirement, according to year of retirement. Such rates are shown in Table 3 and Chart A for the average-earnings individual who worked between ages 62 and 65. Table 3 also shows such data for retirement at age 62.

TABLE 3.—ILLUSTRATIVE REPLACEMENT RATES FOR MEN [1] WITH AVERAGE EARNINGS WHO RETIRED IN VARIOUS YEARS

[In percent]

Year of attainment of age	Retiring at age 62	Retiring at age 65
1972	27.4	35.3
1973	30.7	39.2
1974	30.0	37.8
1975	32.4	40.4
1976	33.2	42.1
1977	33.7	43.3
1978	34.6	45.0
1979	[2] 34.8	45.5
1980	[2] 33.1	47.1
1981	33.0	51.1
1982	32.6	46.6
1983	34.0	45.7
1984	34.2	42.7
1985	33.9	40.8
1986	34.4	41.1
1987	34.8	41.1
1988	[2] 34.3	[3]41.4

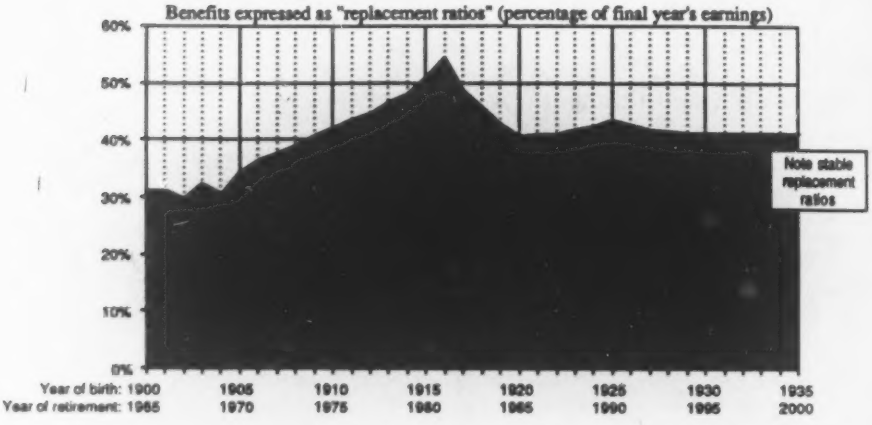
[1] Man attains the specified age at beginning of year and retires then. Figures for attainments of age 65 in 1978 and after are also applicable to women; for earlier years in the table, the figures for women are somewhat higher.
[2] Benefit is computed under the transitional-guarantee method.
[3] Figure for average wage for 1987 is from 1988 Trustees Report.

The data for the average-wage person retiring at age 62 show much greater stability in the replacement rate for persons attaining such age in 1976 and after than those for persons retiring at age 65. For the age-62 retirees, the rates are about 33–34% in all years. This clearly demonstrates that the extent of any notch problem for those who retired at age 62 (about one-third of all 1979 retirees and a somewhat higher proportion of later retirees) is relatively small, especially as compared with the situation for age-65 retirees.

On the other hand, the data for those retiring at age 65 show that the replacement rates for those retiring in 1985 and after (born in 1920 and after) are level at about 41%, which is somewhat higher than for those retiring at age 65 in 1975 or before. However, the rates for those retiring at age 65 in 1976–81 rise steadily and show clearly the big advantage accorded those born in 1911–16 who worked up to age 65. This is the group that has come to be called the "bonanza group".

Chart A

REPLACEMENT RATES (PERCENTAGE OF FINAL YEAR'S EARNINGS) PAYABLE TO WORKERS RETIRING IN VARIOUS YEARS AT AGE 65, HAVING HAD AVERAGE EARNINGS DURING THEIR CAREERS



Source: Office of the Actuary, Social Security Administration, January 27, 1988.

4. The benefits paid to the notch group (those born in 1917 and thereafter) are at about the level that Congress intended for all future retirees, whereas the benefits paid to those born in 1911–16—especially those who worked well beyond age 62—are higher than Congress believed desirable.

The entire "notch" problem arose from a technical flaw in the 1972 Amendments, which, under the actual economic experience, was producing ever-increasing replacement rates, instead of level ones, as had been intended.[1] This technical flaw in the 1972 Amendments produced the increasing replacement rates shown in Chart A and Table 3—culminating, for the average-earnings worker retiring in 1981 at age 65, in a 51.1% replacement rate. In comparison, the replacement rate for a similar worker retiring in 1973 was only 39.2%.

This ever-increasing replacement rate trend had to be corrected, or workers would eventually have received benefits higher than their recent earnings, and the system would have gone bankrupt. A level replacement rate had to be substituted for the projected ever-higher replacement rates, and this was the principal goal of the 1977 Amendments. The level line in Chart A for those retiring in 1985 and later at age 65 shows the stable replacement rate that the 1977 Amendments were designed to produce, so as to accomplish this goal of stability.

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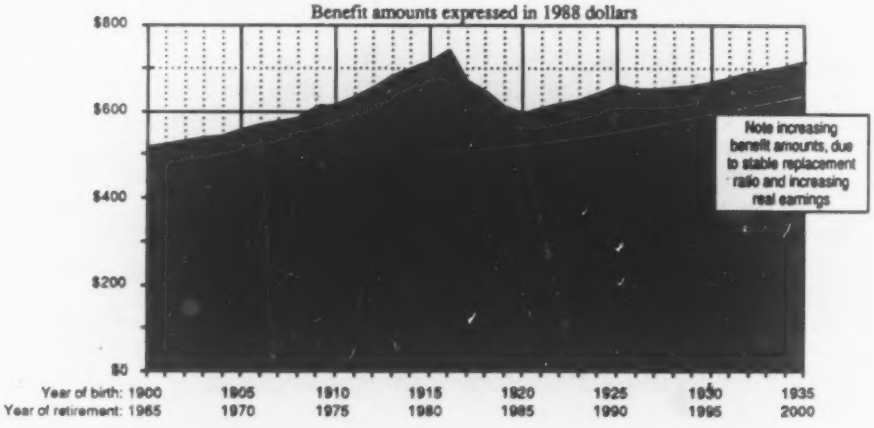
[1] This result is commonly, although somewhat incorrectly, referred to as "double indexing", because the benefit level, both after and before retirement age, was indexed by price changes, and because the insured persons had earnings records that were affected by wage increases. Under some economic scenarios, no flaw would have occurred (see Appendix D). For more details, see Robert J. Myers, "The Social Security Double-Indexing Myth", Benefits Quarterly, Third Quarter, 1986.

The benefit computation procedure in current law which produces these stable replacement rates is based on Average Indexed Monthly Earnings (AIME).[2] The result of this and various other technical provisions governing the benefit-computation procedure is a level replacement rate indefinitely into the future. In all probability, this will result in a more or less steady increase in the level of real dollar benefits as wages and prices move upward. Chart B shows the benefit amounts for the average-earnings worker retiring at age 65, expressed in 1988 dollars.

Chart B

ILLUSTRATIVE SOCIAL SECURITY BENEFITS PAYABLE TO WORKERS RETIRING IN VARIOUS YEARS AT AGE 65, HAVING HAD AVERAGE EARNINGS DURING THEIR CAREERS


Benefit amounts expressed in 1988 dollars
$800
$600
$400
$200
$0
Note increasing benefit amounts, due to stable replacement ratio and increasing real earnings
Year of birth: 1900 1905 1910 1915 1920 1925 1930 1935
Year of retirement: 1965 1970 1975 1980 1985 1990 1995 2000

Source: Office of the Actuary, Social Security Administration, January 27, 1988.

In brief, the way that the formula works is that benefits are based on indexing the earnings record by wage changes up to age 60, using actual earnings for ages 60 and after, and indexing benefits by price changes from age 62 on. (For a detailed discussion of the benefit-computation procedures of the 1972 and 1977 Amendments, as well as a further discussion of the transitional-guarantee provision of the 1977 Amendments, see appendix D.) A different benefit formula applies for each birth cohort (i.e, those born in 1917, those born in 1918, etc.); the "dollar band" factors in the formula are modified each year to reflect changes in average wage levels.

If, for steady workers, wage and price levels move, over the years, in fixed relationships (e.g., wages increase 5.5% per year, and prices rise 4% per year), it can readily be demonstrated mathe-

[2] In computing average earnings for benefit purposes, the calculation is made from the individual's highest earnings in a specified number of years. Such number depends primarily on the individual's year of attainment of age 62 (or disability or death if this occurs before age 62); the number cannot exceed 35 in any event. Before selecting the highest earnings and averaging them, the earnings before age 60 (or before the second year prior to disability or death if this occurs before age 62) are "indexed" (i.e., increased) so as to reflect the growth in nationwide wages in the past (for more details, see of Appendix D).

matically that the replacement rates will remain constant. However, the dollar amounts of the benefit for comparable earnings histories and ages at retirement will increase for each cohort. This will also be the case, although to a lesser extent, for the *current* benefits payable to those who retired in earlier years.

A specific example may make this clearer. Assume that, over many years, wages increase by 5.5% per year, and prices increase by 4% per year. Consider the Primary Insurance Amounts (PIA) [3] of persons retiring at age 62 (whose actual monthly benefits will be 80% of the PIA) who have had earnings equal to the nationwide average wage for their entire working career. In all cases, the PIA replacement rate will be 41%, but the *initial* benefit amount will be 5.5% higher for each successive cohort. However, when the *current* benefit (i.e., that payable in the current year, regardless of when retirement occurred in the past) is considered, the benefit for those who retired in the current year will be about 1.5% higher than that for those who retired in the previous year. The reason for this is that the Cost-of-Living Adjustment (COLA) of 4% narrowed down the 5.5% difference in the initial awards to this extent. Similarly, a 1.5% differential will exist between each successive cohort for earlier years of retirement.

This was the intent of the 1977 Amendments, and the way that the system is working. It was planned that, for any particular age at retirement, the replacement rates should remain level. As a result, the dollar benefits payble as of the date of retirement will keep up to date with rising wages, so that the level of living of beneficiaries rises to the extent that real wages rise.[4]

However, the benefit-computation procedures in the 1977 Act were not applicable to those who attained age 62 before 1979. Their benefits continued to be computed under the faulty procedure in the 1972 Act (as described in detail in Appendix D), even with respect to earnings after 1978. Thus, this group continued to receive windfall benefits insofar as they worked after age 62.

In general, Congress had the same intention in 1972 as it did in 1977—that is, to establish an automatic system that would keep benefits at the time of retirement up to date with wages, and up to date with prices thereafter. The idea was to have a stable replacement rate and, with benefits once awarded, stable purchasing pow However, the actual economic conditions following the 1972

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[3] The Primary Insurance Amount is the basic benefit for which a single retired worker (or a married worker, exclusive of any additional benefits for spouse or children) is eligible to receive as old-age insurance benefits at the Normal Retirement Age (currently, age 65).

[4] If the relationship between wage and price changes does not remain fixed over the years, small notches can occur from time to time. For example, assume that wages have been increasing for many years at a 6% rate and prices at a 4.5% rate, but then in year "t", prices increase 9%, and wages increase 6%, while in year "t+1", prices remain unchanged, and wages again rise 6% (and, in all future years, the 6%/4.5% relationship applies).

The PIA replacement rates will remain level at 41%, but the *current* benefits will show a small notch among retirement-year groups. Those retiring at the beginning of year "t" will have a current benefit amount that is about 3% higher than those retiring in year "t+1" (because, although the latter have a 6% larger amount than the initial award of the former, such initial award is increased by a COLA of 9%). Further, those retiring in year "t+2" will have a benefit amount at award which is 6% higher han the then-current amount for retirees in year "t+1" and about 3% *higher* than for retirees in year "t" (because *no* COLA was paid in year "t+2" because prices remained unchanged in year "t+1").

Thus, it is the nature of the current benefit-computation procedure that small notches can occur between adjacent cohorts, even though all other conditions are the same. (For further details on this complex matter, see pages 177 to 179 of item 8 in the Bibliography, Appendix C.)

Amendments and a technical flaw in those amendments resulted in the constantly increasing replacement rates and benefit levels that outpaced increases in wages. The 1977 Amendments corrected the flaw and carried out the earlier intention.

If the 1977 solution had been adopted in 1972, the benefit for retirement at age 65 for a person born in 1916 would have been computed by the following formula: 90% of the first $170 of AIME, plus 32% of the $854 of AIME, plus 15% of AIME in excess of $1,024. (This formula is derived by projecting back the bend points of the formula for the 1917 cohort group by taking into account the increase in nationwide average wages from 1976 to 1977, 5.9932%.)

Under this formula, the benefit payable for January 1982 for a person who was born at the end of 1916 and who retired at the end of 1981 with an average-earnings history would have been $503. This is $120 less than the benefit actually paid ($623) and is actually slightly—but appropriately—less than the benefit of a similar person who was born a few days later, at the beginning of 1917 ($535). This confirms that the benefits payable to those born in 1917 and after are at an appropriate level according to the intent of Congress, but that those for persons born in earlier years who worked beyond age 62 (after 1978) are unduly high. Appendix E provides a more technical analysis of the points made in this section.

5. The later the age at retirement, the greater the benefit difference or "notch"—because of the differences in the benefit-computation methods in the 1972 and 1977 Acts as they were affected by the economic conditions of the 1970s and early 1980s.

Table 4 illustrates the notch for people retiring in different years for two earnings histories. As the date of retirement occurs later, the difference in benefits (or notch) increases significantly. The differences for retirements at age 62 are quite small (and about half the beneficiaries apply for benefits at age 62). But the differences increase to almost $150 per month for the average-wage case and $200 for the maximum-wage case (for retirement at ages 68–70).

TABLE 4.—ILLUSTRATIVE INITIAL MONTHLY BENEFITS FOR PERSONS BORN IN LATE 1916 AND EARLY 1917 WHO HAVE SAME EARNINGS RECORD AND RETIRE ON SAME DATE

Date of retirement	Average-wage earner			Maximum-wage earner		
	Born in 1916	Born in 1917	Difference	Born in 1916	Born in 1917	Difference
January 1979	$312	$306	$6	$395	$388	$7
January 1980	388	365	23	493	463	27
January 1981	500	449	51	635	570	65
January 1982	623	535	88	789	679	110
January 1983	716	592	124	900	755	145
January 1984	773	638	135	990	826	164
January 1985	834	691	143	1,084	904	180
January 1986	894	747	147	1,178	985	193
January 1987	937	794	143	1,255	1,056	199

Note.—Figures rounded down to exact dollars (when not already an exact dollar).

The more favorable treatment of earnings after age 62 under the 1972-Act procedure than under the 1977-Act procedure can be explained as follows: In determining the average earnings on which benefits are based, earnings at and after the initial benefit computation point (age 62) can be substituted for earlier years of lower earnings. Under the 1972 law, this procedure frequently increased average wages substantially, and thus also benefits. Under the 1977-Act benefit-computation procedure, wages before age 60 are indexed, whereas later earnings are not indexed, but rather are used in their actual amounts. As a result, such later earnings are not usually much higher than such indexed earlier earnings; thus, when used, they do not result in significant increases in the average. The same thing occurs when persons retire at age 62 or older and then return to work and later obtain benefit recomputations.

Furthermore, the economic conditions in the 1970s and early 1980s (when prices and wages both increased greatly—and, at times, prices rose more rapidly than wages) made the difference in the results from the two procedures even more important. Thus, the notch became larger than it would otherwise have been if economic conditions had been "normal" (i.e., as had been anticipated in the mid-1970s when the legislation was being developed).

6. The "notch" arises because those born in 1911–16 are receiving an unintended windfall—not because those in the "notch group" receive "too little". It was inevitable that, if correction for replacement rates that were too high were made, birth cohorts following those who had been receiving excessive benefits would get less. The notch situation could have been reduced—and, in many cases, eliminated altogether—if, in 1977, Congress had adopted a provision that placed a cap on the windfall being received by workers born before 1917 who worked in 1979 and after.

It is clear that the flaw in the benefit-computation procedures in the 1972 Amendments had to be corrected if the replacement rates intended to be produced by the 1972 Amendments were to be achieved or, at least, to be more nearly replicated. If the increased replacement rates that had developed by 1977 were to be maintained for future retirees, sizable increases in the cost of the program would have been involved. And Congress did not wish to have this occur. It is also clear that, in those corrections, some birth cohorts had to get lower benefits than those who are receiving benefits higher than had been intended. There is no way that this conclusion can be avoided, and to increase benefits for those born after 1916 would simply expand the number of people who would receive an unintended windfall. This conclusion is borne out by all of the preceding analysis.

It would have been possible, however, largely to have prevented the windfalls for persons born in 1916 or before who worked beyond age 62 (after 1978) by not continuing completely for them the faulty benefit-computation method resulting from the 1972 Amendments.

Such individuals could have been given both the accrued benefit amount as computed under the 1972 Act for all earnings credits for employment before 1979, including all COLA's thereon (both past

and future) and also an additional benefit based on earnings credits acquired after 1978. Such additional benefit would be based on the *excess* of (a) the benefit amount as computed under the AIME method for all earnings credits acquired after 1950 over (b) the benefit amount as computed under the AIME method on earnings credits only for 1951–78. In making these computations, the AIME benefit formula for the 1979 cohort would be used, with indexing of past earnings to 1977 and with continuation of the 1% Delayed-Retirement Credit applicable to persons born prior to 1917 (rather than 3%, as applies for persons born in 1917 and after).

As a specific example, consider a person who attained age 62 in 1978, but who worked until retiring at the end of 1981. The 1977 Act could have based the total Primary Insurance Amount on the sum of the PIA determined as of the end of 1978, plus all subsequent COLA's, and the PIA based on the excess of (a) the PIA computed under the AIME method determined from earnings through 1981, including the appropriate COLA's over (b) the PIA similarly computed, but based on earnings only through 1978. Appendix F gives the detailed computations for such an individual who had maximum covered earnings in all years in 1951–81.

Table 5 shows the effect of such a revised benefit-computation procedure for persons who attained age 62 at the end of 1978, as against what present law provided for persons who attained age 62 early in 1979. Data are presented for various retirement dates and two earnings levels. As Table 5 clearly shows, the revised benefit-computation method—if only it had been adopted in 1977—would have prevented most of the "notch" problem.

TABLE 5.—ILLUSTRATIVE INITIAL MONTHLY BENEFITS FOR PERSONS BORN IN LATE 1916 UNDER WHAT WOULD HAVE BEEN PROPER PROCEDURE AND FOR PERSONS BORN IN EARLY 1917 UNDER PRESENT LAW WHO HAVE SAME EARNINGS RECORD AND RETIRE ON SAME DATE

Date of retirement	Average-wage earner			Maximum-wage earner		
	Born in 1916	Born in 1917	Difference	Born in 1916	Born in 1917	Difference
January 1979	$312(312)	$306	$6	$395(395)	$388	$7
January 1980	374(388)	365	9	477(493)	463	14
January 1981	464(500)	449	15	597(635)	570	27
January 1982	557(623)	535	22	722(789)	679	43
January 1983	613(716)	592	21	793(900)	755	38
January 1984	651(773)	638	13	859(990)	826	33
January 1985	693(834)	691	2	922(1,084)	904	18
January 1986	723(894)	747	–24	969(1,178)	985	–6
January 1987	767(937)	794	–7	1,049(1,255)	1,056	–7

Note.—Figures in parentheses are benefits under 1972 Act basis (i.e., present law). The difference between such figure and the figure to its left represents the portion of the notch which is due to the windfall resulting for persons born before 1917 who work well beyond age 62 (after 1978). Figures rounded down to exact dollars (when not already an exact dollar).

This is vivid proof that persons born in 1917–21 have not been unfairly discriminated against. Rather, those born before 1917 who worked well beyond age 62 after 1978 have received undue windfalls. The figures in parentheses in the two "Born in 1916" columns show the actual benefits payable to these persons and clearly demonstrate that the vast majority of the notch problem is due to the windfall which is represented by the differences between the fig-

ures in parentheses and those immediately to their left. The differences between the benefits of those born in 1916 as compared to those born in 1917 are, on the whole, only about one-fifth as large for the alternative procedure as under present law.

7. Reducing the "notch" now by cutting the benefits of those receiving the unintended windfall would require reducing benefits for those already receiving them and who are counting on a continuation of the level of benefits awarded to them. Conversely, increasing the benefits of those born in the notch years would, in turn, create new relative notches affecting those born in later years (and also would increase the already unfavorable differential against those born in about 1910 or before).

Since the "notch" is caused by benefits for those born in 1911–16 being higher than was intended, it might seem at first glance that the solution to the "notch" problem would be to reduce those benefits to the replacement rates intended and provided by the 1977 benefit-computation procedure. This is, of course, a logical possibility, although it would mean reducing the benefits of people who have been receiving them, in some instances for a long time, and who are counting on the level of benefits they are receiving in their retirement planning. Both Congress and the Executive Branch, in the past, have shown great reluctance to reduce benefits already awarded. This "solution" is of doubtful equity and, of course, would do nothing to help the group born in 1917 and after who are complaining.

On the other hand, if benefits were to be increased for those in the notch years (however defined, whether births in 1917–21 or in some longer period after 1916), this would create a new notch in benefits when considered relative to earnings (i.e., in replacement rates as are displayed in Table 3). Also, the already-existing unfavorable differential in replacement rates for persons born before about 1910 as against those for persons born in 1917–21 (see Table 3 and Chart A, for attainments of age 65 before 1975)--which could be referred to as another notch—would be widened.

IV. REVIEW OF PENDING LEGISLATION AND VIEWS OF VARIOUS ORGANIZATIONS

A number of bills have been introduced to increase benefits for the "notch babies", and several Members of Congress have testified in favor of such bills. Other Members, however, have expressed opposition to such legislation, and favor no action on the notch. Appendix G presents a brief summary and cost analysis of various pending bills that address the notch issue, prepared by the Congressional Research Service. It should be noted that the cost projections are only for nine years and do not include the substantial costs beyond then.

As part of its study of the notch, the panel invited interested organizations and individuals to submit written testimony on this issue. In addition, the panel had the benefit of reviewing testimony submitted to the Senate Special Committee on Aging at its hearing on February 22, 1988 and to the House Ways and Means Subcommittee on Social Security at its hearing on April 14, 1988. The following discussion relates to views expressed by large national organizations.

The National Committee to Preserve Social Security and Medicare (NCPSSM) emphasized that correcting the notch is one of its major legislative proposals. Its representatives testified that the transition enacted in 1977 did not work as Congress intended, and it favors increasing benefits by enacting a new and longer transition period, as proposed in the Ford/Sanford bills (H.R. 3788/S. 1830). The NCPSSM testified that such a change would not undermine the financing of the trust funds, and it would increase the public perception of the system's fairness.

The Veterans of Foreign Wars of the United States and the Gray Panthers favored legislation to correct the notch, as a matter of equity.

The American Association of Retired Persons (AARP) testified that no legislation on the notch is needed, because beneficiaries born after 1916 are receiving proper benefits. AARP emphasized that any change would significantly undermine the financial integrity of the system and create intergenerational inequities in the future.

The National Council of Senior Citizens (NCSC) recommended that no legislative action be taken on the notch, and expressed concern over the fact that the changes supported by other groups are extremely costly and would put the system at serious financial risk. The NCSC supports a massive public education effort to explain the facts of the notch, and to dispel the perception of unfairness in the Social Security system.

Save Our Security (SOS), a coalition of 110 national, State, and local organizations, submitted testimony stating that the action taken by Congress in 1977 was responsible and that benefit levels

have evolved as intended by the 1977 legislation. SOS cautioned that any changes would have significant costs and would weaken the financial foundation of the system, unless accompanied by increases in the payroll tax. SOS suggested that the 1989 Advisory Council on Social Security could be a forum for further iscussion of the notch, if deemed necessary. Forty-two of its constituent organizations co-signed the SOS testimony, as presented before the Senate Special Committee on Aging.

The United Transportation Union, whose members are covered under the Railroad Retirement program but are affected by the notch situation through their tier-I benefits, expressed the view that, in the light of cost considerations, no legislative action on this matter should be taken. The National Grange expressed a similar view. The American Academy of Actuaries summarized the situation as to how the notch occurred and pointed out that persons born after 1916 are equitably treated and receive reasonable benefit amounts.

In addition to the aforementioned groups, other individuals and organizations from across the country have expressed views on both sides of the notch; some favor no legislative action, while others support a variety of proposals to increase benefit levels for those affected by the notch.

V. RECOMMENDATION OF THE PANEL

Since the "notch" arises because the benefits of some of those born prior to 1917 are higher than was intended, there is no reasonable basis for reducing the "notch" by raising the benefits of those born later. Nor is it desirable to reduce the benefits of those already receiving them and counting on their continuation. Therefore, the panel recommends no change in present law that would either award additional benefits to those born after 1916 or lower benefits for those born prior to 1917.

Several courses of action could be taken in response to the "notch". Additional amounts could be paid to those with "low" benefits—as would be done, in ingenious, but administratively complex manners, in a number of pending bills (which are described, as to provisions and added cost, in the GAO report—item 5 in Appendix C).

The panel has not analyzed each of these pending bills, as to their individual merits or disadvantages, in this report because it believes that no action to increase benefits for this special group alone should be taken. On the other hand, reductions could be made for those with "high" (or "bonanza") benefits—either all at once or gradually in the future (such as by withholding COLA's); no pending bill proposes this. Still another course of action would be to leave the present law unchanged.

Some who advocate paying additional amounts to certain beneficiaries who were born in 1917 or later—which could result in increased expenditures from the trust funds of $50–300 billion over the years, depending upon the proposal—assert that the monies to do so are readily available, because of the projected huge build-up of the trust-fund balances in the next three decades. Without taking any position on whether such a build-up is (or is not) desirable, the panel points out that, if monies in the trust funds are used for this purpose, the adequate financing of the entire program would be adversely affected. As a result, additional revenues of equal magnitude would need to be raised in some manner at some future time.

Those who suggest increasing the Social Security benefits of persons in the notch group have not identified, clearly and specifically, the source of additional revenue to pay for such increases. Because the OASDI program is currently in close long-range actuarial balance, any significant increase in benefit outgo cannot be financed out of currently forecast revenues or the existing fund balance.

This panel has come to the conclusion that, although the present situation is undesirable and unfortunate, no change in law is desirable. To do so by significantly increasing benefits of some persons who were born in 1917–21 (or even several later years)—as would the several aforementioned pending bills—would be very undesir-

able, based on cost, administrative feasibility, and equity considerations. Huge costs over the years ahead would be involved, as well as difficult and costly administrative procedures. The additional benefits would go to persons who are already receiving proper and equitable amounts and would result in further notches and inequities against other groups of beneficiaries whose benefits would not be raised. The elimination or reduction of one perceived inequity would simply introduce a new inequity in the benefit structure—beneficiaries in the current notch group would have higher replacement rates than those born in later years.

It would now be inequitable and contrary to past policy to reduce real benefits to men and women well into their retirement. Moreover, it would be very difficult to make such reductions—both from a public-relations viewpoint and from an administrative standpoint.

In summary, the panel reiterates that the real problem in this matter is that those persons who were born before 1917 who worked well beyond age 62 after 1978 receive undue windfalls. Those born after 1916 are equitably treated, consistent with the intent of Congress, and receive proper benefit amounts (which, incidentally, are far more than the amounts "actuarially purchased"). There is no reason why younger workers should, over the years, pay more taxes to provide windfall benefits to this group. Conversely, although there is a case for reducing (gradually or otherwise) the windfall benefits for some persons born before 1917, this would not now be equitable. The panel therefore recommends that Congress take no legislative action on the notch issue.

APPENDIX A—LETTER OF REQUEST FOR STUDY

UNITED STATES SENATE

March 7, 1988

Hon. Robert M. Ball,
National Academy of Social Insurance,
Washington DC

DEAR MR. BALL:

We request that the National Academy of Social Insurance conduct a study of the Social Security "notch" issue. In our judgment, policymakers would benefit significantly from the Academy's nonpartisan expertise on this important subject.

The study should include a background examination of the legislation and economic conditions that created the disparity in benefit levels between beneficiaries born before 1917 and those born later. It should identify all options and analyze the impact of each on Social Security beneficiaries and taxpayers and the old-age and survivors insurance trust fund. We hope that your findings and recommendations would be available this spring.

We look forward to your response to this request.

Sincerely,

DANIEL PATRICK MOYNIHAN,
Chairman,
Subcommittee on Social Security and Family Policy

ROBERT DOLE,
Ranking Minority Member,
Subcommittee on Social Security and family Policy

APPENDIX B—PURPOSES AND ORGANIZATION OF THE NATIONAL ACADEMY OF SOCIAL INSURANCE

MISSION

The National Academy of Social Insurance is a nonprofit, nonpartisan organization devoted to furthering knowledge and understanding of Social Security and related programs.

GOALS OF THE ACADEMY

1. To create a forum in which to explore and debate issues facing the field of social insurance;
2. To encourage the development of future scholars and administrative leaders;
3. To promote and support research on social insurance programs, their relationship to other public and private programs and other issues; and
4. To increase opportunities for the public to learn about social insurance programs and issues.

ACADEMY MEMBERS

The Academy's Founding Members are recognized experts on the Old-Age, Survivors, and Disability Insurance program, commonly referred to as "Social Security". They actively participate in social insurance policy and practice by writing, reviewing, speaking, conducting research, administering and teaching others about Social Security and related programs. Membership is by invitation of the Board.

ACADEMY AUDIENCES

- Recognized experts in social insurance, including Members of Congress and their staffs, administrators, policymakers and representatives from government, industry, and labor, and scholars from the disciplines of actuarial science, economics, history, law, political science, public policy, and social welfare;
- Students at the undergraduate, graduate, and doctoral level and mid-career professionals who are undertaking advanced study of social insurance issues in the disciplines comprising the field of social insurance; also, the instructors and professors who teach and advise them;
- Staff of Congress and Senate members' offices, key Congressional committees, the General Accounting Office, the Congressional Budget Office, the Congressional Research Service, the Health Care Financing Administration, the Social Security Administration, the Office of Management and Budget, and other offices of the executive branch;

- Researchers undertaking the study of issues related to social insurance;
- The American public, including those workers and employers that contribute to the Social Security trust funds and those receiving benefits as retirees, survivors, dependents and the disabled; also, those representing these groups in the policymaking process: business, labor, and consumer advocacy groups.

Academy Activities and Services

The Academy is a **Resource Center for Current Social Insurance Experts.** There are numerous opportunities for active exchange of ideas among these experts and with a wider audience. They receive a bi-monthly newsletter and a weekly news clipping service. The Academy sponsors an annual meeting of these recognized experts.

The Academy has designed the **Education Program for Leadership Development in Social Security and Related Programs,** which consists of student internships, faculty, and doctoral fellowships, student awards, library of key historic and current references on the Social Security Program, an annual lecture and a book of *Readings on Social Security and Related Programs.*

The Academy's **Program of Research** includes an annual research conference, published proceedings, study panels on specific issues, consultation by experts, research awards, and grants to help support selected research projects or publications.

The Academy has begun four activities as part of its **Public Awareness Initiative:** an Information Clearinghouse, a Speaker Referral Service, a Manuscript Review Service, and Public Forums. In addition, for the Washington audience of policymaking and administrative staff, a series of issue discussion groups and seminars is planned.

Board of Directors

Members of the Board of Directors are **Henry Aaron,** Senior Fellow, Brookings Institution; **Nancy Altman,** Lecturer in Public Policy, John F. Kennedy School of Government, Harvard University; **William Arnone,** Director of Pre-Retirement and Financial Planning Services, Buck Consultants; **Robert M. Ball,** former Commissioner of Social Security; **Dwight K. Bartlett, III,** President, Mutual of America Life Insurance Company; **Merton Bernstein,** Professor of Law, Washington University School of Law; **Lisle C. Carter, Jr.,** General Counsel, United Way of America; **Theodore R. Marmor,** Professor of Public Health and Political Science, Yale University; **Alicia H. Munnell,** Senior Vice President and Director of Research, Federal Reserve Bank of Boston; **Robert J. Myers,** former Chief Actuary and Deputy Commissioner, Social Security Administration; **Robert R. Nathan,** Consulting Economist; **Bert Seidman,** Director, Department of Occupational Safety, Health and Social Security, AFL-CIO; **Lawrence H. Thompson,** Assistant Comptroller General, General Accounting Office; **Elizabeth Wickenden,** Director, Study Group on Social Security; and **Howard Young,** Independent Consultant and Adjunct Professor, University of Michigan and former Special Consultant to the President, United Auto Workers.

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APPENDIX D—WHAT CAUSED THE NOTCH, TOGETHER WITH DESCRIPTION OF METHODS OF BENEFIT COMPUTATION UNDER THE 1972 AND 1977 ACTS

In considering the "notch" in Social Security benefits, it is desirable to explain what caused the notch, which involves a discussion of the general background of the benefit-computation procedures in the 1972 and 1977 Acts. Following this is an explanation in some detail as to the procedures used to determine benefit amounts under the 1972 and 1977 Acts, including for the latter the special transitional-guarantee provision that was made available only to persons born in 1917–21, the so-called "notch babies".

The Social Security Amendments of 1977 made several changes in the method of computing benefits. The benefit-computation method introduced in the 1972 Amendments continued to be applicable to all those born in 1916 or before, whereas those born in 1917 and later had their benefits computed under the new provisions. The different benefit amounts resulting from these two methods of computation produced the "notch". An important point to keep in mind is that the changes unintentionally affected the computation of benefits for those who retired at age 62 differently than they affected benefits for those who worked beyond age 62, so that there is a larger notch between those who worked for a considerable period after age 62 than for those who did not. In part, this unintentional effect arose because of the economic conditions experienced after 1977.

General Basis of Benefit Computation Under 1972 Act, and Why the Method Had to Be Changed

The 1972 Amendments first introduced a method of automatically keeping Social Security benefits up to date with rising prices. The method used was the same as that used from time to time in ad hoc legislation in the past to update benefits to changes in wages and prices. However, under the economic conditions that prevailed after the 1972 Amendments went into effect, the procedure proved faulty. Under the assumptions used in the long-range actuarial estimates that were made in the mid-1970s about the future relationship of wages and prices, this benefit-computation method would have greatly increased replacement rates, and thus the cost of the system.

Here is the way the 1972-Act formula worked. Benefits were determined by a table in the law. For each Average Monthly Wage level (actually shown in groups of average wages), as defined for Social Security purposes, there was a specified benefit amount. Under the automatic provisions, when the Consumer Price Index (CPI) went up 3% or more, the benefit amount for each average-wage interval in the table was increased by the same percentage as

the rise in the CPI. Thus, in early 1977, a $300 Average Monthly Wage produced a benefit of $246.50. In June 1977, there was a 5.9% increase in the benefits, and the benefit table was rewritten so that an Average Monthly Wage of $300 produced a benefit 5.9% higher, or $261.10.

As prices rise, however, so do earnings, and the higher wages were included in the computation of the Average Monthly Wage on which the Social Security benefit was based. Thus, on retirement, say in 1985, the worker who had an Average Monthly Wage under Social Security of $300 in 1977 would no longer have had an average wage of $300, but—depending on the number of wage increases he or she had had since 1977—would have reached a higher average wage. The benefit was no longer the amount shown n the table for the $300 average wage, but rather an amount related to some higher average wage. Thus, it was a combination of the increase in the Social Security benefit for any particular average-wage level *plus* the increase in the average wage itself which resulted in an updating of the level of protection for those retiring in the distant future.

While this indexing formula worked reasonably well for persons retiring at age 62 in the early 1970s, it was very sensitive to the behavior of wages and prices for those still working who would retire many years off in the future. For example, if wages and prices rose an average of 6% and 5% per year, respectively, by the year 2050, in most cases, benefits would have been higher than any wages the worker had ever earned. On the other hand, if wages and prices rose 5% and 2%, respectively, replacement rates for the average worker would drop from 41% in the 1970s to about 30% by 2050. If the relationship of wages and prices continued after the 1972 Amendments to have maintained approximately the same relationship as they had in the 20 years previously (a 4.3% increase in wages as compared to a 2.3% increase in prices), the benefit-computation procedure would have produced a more or less level replacement rate. However, under the conditions of rapid inflation which were experienced after the 1972 Amendments, and the projection of both a higher rate of inflation and a smaller gap between increases in wages and prices for the future, the 1972 computation method was shown to be seriously flawed.

General Basis of 1977-Act Benefit-Computation Procedures

The 1977 Amendments solved the foregoing problem by eliminating the interaction of wages and prices in the benefit-computation procedure. Basically, the computation of benefits was based on past earnings, with such earnings indexed (or adjusted) to reflect changes in the general level of wages. Retirement benefits for those on the roll were kept up to date with price increases following the attainment of age 62. This separation of the effect of wages on benefit levels and the effect of prices on benefit levels came to be referred to as "decoupling". The interaction of wages and prices in the 1972 benefit-computation procedure has been referred to in shorthand (although somewhat incorrectly) as "double indexing".

Under the 1977 Amendments, replacement rates are kept level for retirees in various future years, indefinitely into the future, by

indexing the earnings records up to age 60 (actual earnings are used after that) and also indexing the formula itself to the rise in average nationwide wages. The amount of earnings subject to a particular percentage in the benefit formula is increased automatically as average wages in the nation rise. This combination of indexing the entire earnings record up to age 60, and indexing the benefit formula as well, will result in replacement rates 20, 30, or 40 years from now that are the same as replacement rates today. The purchasing power of benefits is separately maintained by indexing the benefits to the Consumer Price Index, as in the 1972-Act procedure.

Detailed Description of Method of Benefit Computation Under the 1972 and 1977 Acts

The Primary Insurance Amount (PIA) is the basic benefit for which a single retired worker (or a married worker, exclusive of any additional benefits for spouse or children) is eligible to receive as old-age insurance benefits at the Normal Retirement Age (currently, age 65). Almost all OASDI benefits are derived, directly or indirectly, from this basic benefit amount. The procedures under both the 1972 and 1977 Acts provided a method by which the PIA could be computed using a worker's covered earnings history and also certain additional information about price inflation and, as to the 1977 Act only, the rate of growth in average nationwide wages. Note that the term "earnings" includes both wages as an employee and self-employment income.

Period Used for Averaging Earnings.—The PIA under either formula for retirement benefits for persons who had not had a previous "period of disability" is ultimately based upon a worker's average covered lifetime earnings after 1950 (in a few unusual cases, a computation method using earnings back through 1937 is used if it produces a larger amount). Average earnings are calculated as the worker's average monthly earnings during those years of highest earnings in the worker's "base years" after 1950. The number of years to be used in this computation depends on the worker's calendar year of birth. The PIA of someone born in 1917, for example, depends upon average earnings in the *23* years of highest earnings (the number of years after 1950—or the year of attainment of age 21, if later—and before the year of attainment of age 62, minus 5 years). The PIA of someone born in or after 1929 depends on average earnings received in the *35* years of highest earnings. Persons who have had a period of disability and who recovered before age 62 have their average earnings computed over a shorter period.

1972-Act Benefit-Computation Formula.—Under the 1972 Act, the worker's Average Monthly Wage (AMW) was used to determine the PIA. For example, underlying the table in the law, the approximate basic PIA formula applicable for benefits for June 1976 through May 1977 consisted of eight brackets as follows:

137.77% of the first $110 of AMW
+50.10% of the next $290 of AMW
+46.82% of the next $150 of AMW

+55.05% of the next $100 of AMW
+30.61% of the next $100 of AMW
+25.51% of the next $250 of AMW
+22.98% of the next $175 of AMW
+21.28% of the next $100 of AMW

Applying the formula to a worker with an AMW of $585 yields a PIA of $386.40—the amount that a fully-insured single worker retiring at age 65 would receive (actually, the benefit payable was $387.30, the difference being due to rounding procedures as to the AMW being considered in bands of several dollars' widths).

The procedure for making cost-of-living adjustments (COLA's) under the 1972-Act procedure was quite straightforward. Each year, the percentage factors in the PIA formula were raised in proportion to the increase in the previous year's Consumer Price Index. For example, for benefits for June 1975, the formula set the PIA at approximately 129.49% of the first $110 of Average Monthly Wage, 47.09% of the next $290, 44.01% of the next $150, and so on through the remaining five brackets in the formula. Inflation during 1975 averaged 6.4%, so each of the percentage factors in the PIA formula were raised by 6.4% to reflect the higher price level. The PIA formula automatically changed for benefits for June 1976 to 137.77% (1.064 times 129.49%) of the first $110, plus 50.10% (1.064 times 47.09%) of the next $290, and so forth for the remaining brackets in the formula. This adjustment caused each PIA to increase by exactly 6.4%, the change in the Consumer Price Index during the previous year.

While this indexing formula worked reasonably well for retirees who were already collecting benefits, under certain circumstances it could produce rapid increases in the PIA's payable to new retirees. One of these sets of circumstances arose in the middle and late 1970s when increases in the general price level far outstripped increases in average wage levels. Under these circumstances, the 1972-Act procedure generated adjustments in the PIA formula that caused PIA's to rise more rapidly than wages. As mentioned previously, the flaw in the 1972-Act procedure that caused this to occur is frequently (although erroneously) referred to as "double indexation" of benefits to inflation.

The net result of this combination of rapidly rising initial benefit levels and wages rising relatively slowly (as compared with prices) was that OASDI replacement rates rose much more steeply than Congress had intended when it passed the 1972 Act. New retirees in 1973–77 had unintended windfalls in their benefits. As a result, as mentioned earlier, if the rapid price inflation of the 1970s had continued, and if the 1972-Act benefit-computation procedure had remained in effect, replacement rates for new retirees would eventually exceed 100%.

More fundamentally, soaring initial benefit levels in the mid-1970s threatened the long-term solvency of the OASDI system. The 1972 Amendments had been enacted under the assumptions that average wage levels would rise somewhat more rapidly than prices and that neither would increase very rapidly. When this expectation failed to be realized in the mid-1970s, benefit outlays began to rise more steeply than payroll tax collections. If this process had

continued for long enough, it would have threatened the ability of the system to make benefit payments, even aside from the problem introduced by the so-called double indexation. But the flaw in the computation procedure in the 1972 Amendments made the problem much more severe by raising replacement rates at the same time that there was a slowdown in the growth of real (inflation-adjusted) payroll tax collections.

1977-Act "Permanent" Benefit-Computation Procedure (AIME method).—Under the 1977 Amendments, the flaw in the 1972-Act procedure was removed. Actual benefit amounts continue to be calculated by reference to the PIA, which in turn is based on average lifetime earnings in covered employment. Under the 1977-Act procedure, as applicable on a permanent ongoing basis, the average earnings are, however, calculated in a more complicated way. Before computing average earnings, the earnings in each year of the earnings record is multiplied by an index factor that reflects the growth in nationwide wages that has occurred since that year. For example, if average wages when a worker was age 30 are exactly half the level of wages when he or she attains age 60, the earnings at age 30 are doubled before they are used to calculate Average Indexed Monthly Earnings (AIME). Earnings in and after the year when age 60 is attained are not indexed.

The 1977-Act method of indexing past earnings was a logical way to deal equitably with the effects of past wage inflation and real wage growth in the future. Since average wages tend to rise over time, earnings early in a person's career appear to be very low from the perspective of average wage levels when the worker reaches retirement age. Workers with relatively high earnings early in their careers, but low earnings later, received somewhat inequitable treatment under the 1972 Act procedure, which failed to index past earnings to reflect prevailing wage levels at the time those earnings were obtained. For obvious reasons, the 1972-Act procedure tended to give far greater weight to earnings late in a worker's career, when avearage wage levels were usually highest.

The 1977 Amendments also simplified the basic PIA formula by removing several of the brackets in the earlier formula. Under the new formula, the PIA for an insured worker attaining age 62 in 1988 is equal to (1) 90% of the first $319 of Average Indexed Monthly Earnings, plus (2) 32% of the amount above $319, but less than $1,923, plus (3) 15% of any amount in excess of $1,922. The dollar amounts in this formula, known technically as the "bend points", are adjusted each year to reflect the change in nationwide average wages. However, for any given year-of-birth cohort of insured persons, the bend points are fixed on the basis of prevailing wage levels in the calendar year in which the cohort attains age 60. For each successive cohort, the bend points are therefore likely to be different levels for each cohort. This makes the 1977-Act formula different from that under the 1972 Amendments.

The indexation of earnings before age 60 and the annual adjustment of the bend points in the PIA formula ensures that *initial* benefit levels rise over time in proportion to the rise in wages. If wages increase faster than prices—that is, if inflation-adjusted wages rise over time—real benefits for new retirees will rise pro-

portionately. But if wage growth is less than the increase in prices, initial real benefits will decline. Under the 1972-Act procedure, by contrast, initial real benefit levels could rise, even as prevailing real wage levels were falling.

After an insured worker reaches age 62, he or she is protected against changes in the price level by annual COLA's linked to changes in the Consumer Price Index (except that, when the OASDI trust-fund balances are very low, the COLA is based on the *lower* of the CPI increase or the nationwide average-wage increase). The 1977 Amendments essentially provide that real retirement benefits for a cohort are left unaffected by price inflation that occurs after age 62. Of course, insured workers who postponed their retirement until after age 62 will have their earnings in and after the year of attaining age 62 counted in determining their Average Indexed Monthly Earnings and, hence, their basic benefit levels. But whatever that basic benefit level turns out to be, it is adjusted each year in proportion to changes in the CPI. Hence, its real value is unaffected by the vagaries of price inflation.

One of Congress' main goals in passing the 1977 Amendments was to stabilize benefit replacement rates. The procedure that it adopted established initial benefits at an affordable level while continuing to protect retirees against losses in living standards caused by rapid price inflation over the course of their retirement.

In setting long-term benefit levels, however, Congress consciously *reduced* replacement rates below the level that was expected to prevail in January 1979, when the new system would take effect. The purpose of this reduction was to offset some of the unintended rise in replacement rates for workers retiring in the mid-1970s. This rise, as noted earlier, was an unintended consequence of the defective indexation procedure adopted in the 1972 Amendments. Between 1973 and 1977, for example, the replacement rate for an average-wage worker with steady earnings who retired at age 65 rose from about 39% to 45%. The 1977 Amendments lowered the long-run replacement rate for an average-wage retiree at age 65 to 41–42%, a reduction in the replacement rate of 4 percentage points, or about 10% of the average rate in 1977. This choice of a long-term replacement rate for retirement benefits was based on a delicate assessment of Congress' responsibility to older workers (whose retirement financial plans could be seriously jeopardized by sudden changes in promised benefits) and to younger workers (who would be forced to bear the burden of paying for the extra benefits provided under the flawed benefit-computation procedures of the 1972 Amendments).

Transitional-Guarantee Provision under 1977 Act.—Obviously, there are very important differences between the indexing methods and the PIA benefit formulas adopted in 1972 and in 1977. The benefits that would be calculated for a particular worker under the two procedures would often differ quite widely. In some cases, especially when workers' relative wages were highest early in their careers, the benefit determined under the 1977 procedure would be higher than that under the 1972 procedure. But, benefits would be lower under the 1977 procedure for workers with high earnings late in their careers, which is the usual situation.

The shift in benefit-computation procedures, although necessary to protect the financial integrity of the OASDI system, presented the Administration and the Congress with a very difficult problem. On the one hand, there were strong arguments to preserve the benefits already being paid to current retirees in 1977 and to workers who were about to retire. On the other hand, a compelling need existed to restore the long-term solvency of the program.

This conflict was resolved by having the benefits for workers born before 1917 calculated under the 1972-Act AME procedure, irrespective of when they retired. Workers born after 1921 would have their benefits calculated under the 1977 AIME procedure, regardless of their age at retirement. However, workers born in 1917–21 would have their benefits computed under one of two procedures which were prescribed by the 1977 Act and would be given the higher amount resulting from these two calculations.

The first of these procedures for those born in 1917–21 was simply the AIME one, which applies automatically to all retirees born after 1921. Thus, in no sense do workers in the 1917–21 year-of-birth transition group receive benefits under a less generous formula than workers born in a later year; the transition group always receives benefits that are *no less generous* than those available to later cohorts. The second procedure—the "transitional guarantee"—was provided so that the nominal benefit could never fall below the amount computed under the 1972-Act benefit-computation procedure on the basis of earnings before the year of attainment of age 62.

This transitional guarantee froze the PIA formula in effect in December 1978 under the 1972 Act. The transitional group were guaranteed nominal (not inflation-adjusted) benefits no lower than would be calculated under this formula. The PIA formula was *not* updated each year to reflect the inflation that occurred after December 1978 and before the calendar year in which the worker attained age 62. However, the benefit was updated to reflect inflation that occurred during and after the latter year.

For workers in the transition group who did not attain age 62 until several years after 1978, this temporary loss of protection against inflation could greatly diminish the value of the transitional guarantee. The second important feature of the transitional-guarantee procedure was its exclusion of earnings after the year of attainment of age 61. (These earnings could, of course, be used to calculate benefits under the *new* 1977-Act AIME procedure.) For obvious reasons, this exclusion signifi-cantly reduces the value of the transitional guarantee for workers in the transition group who worked past the year of attainment of age 61.

APPPENDIX E—SUPPLEMENTARY TECHNICAL ANALYSIS

Appendix Table 1 gives illustrative figures for men—in most cases, applicable also for women—for those who retire at age 65 at the beginning of the year. Current monthly benefits for those who had *maximum* creditable earnings in all past years (after 1950) are shown for various years of birth (or, in other words, according to year of attainment of the specified retirement age). The line between the 1981 and 1982 rows separate the notch group (and later ones) from the pre-notch group. Appendix Table 2 gives corresponding figures for those who had average creditable earnings in all years.

Benefits payable currently in 1988 for persons retiring at age 65—i.e., the initial benefit increased by all of the applicable COLAs—reflect the intended phase down for the 1916 births to the later ones. As discussed later, not all of the decrease is due to this intention, but the vast majority of it so arises. A low is reached for the 1920 births (year of retirement 1985), and then a gradual rise occurs.

This latter trend for retirements at age 65—for years of retirement after 1985—results from the long-run tendency for benefits awarded to be somewhat higher from year to year, because of gradually rising wages. Further, when the benefit awards of previous years for persons with the same relative earnings histories are increased for COLA's subsequent to award, the resulting *current* benefit amounts will still usually be lower than for awards of the current year, because wages generally rise more rapidly than prices (the reasons for this are discussed in some detail on pages 12 and 13).

As a result, one would expect that, if the benefit structure were reasonable and equitable, the *current* benefit (that payable in early and mid-1988) for retirement at a particular age for persons with the same relative earnings record would generally increase *gradually* from those from long-distant past years of retirement to that of the current year. This is, in part, what is shown in Appendix Tables 1 and 2 in the trend for the current benefit for retirement at age 65 for year of retirement 1972 up to year of retirement 1981. A portion of the increase from $653.30 to $942.40 for the maximum earner, and from $577.90 to $741.50 for the average earner, is due to this element. Then, all of the increase for year of retirement 1985 up to year of retirement 1988 (i.e., from $780.40 to $838.60 for the maximum earner and from $596.70 to $626.20 for the average earner) is due to this element.

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APPENDIX TABLE 1.—ILLUSTRATIVE CURRENT MONTHLY BENEFITS FOR MEN [1] WHO RETIRED IN VARIOUS YEARS AT AGE 62 OR AGE 65 WITH MAXIMUM CREDITABLE EARNINGS IN ALL PREVIOUS YEARS

Year of attainment of age	Man retiring at age 62		Man retiring at age 65	
	Year of birth	Current benefit	Year of birth	Current benefit
1972	1910	$505.10	1907	$653.30
1973	1911	522.70	1908	670.10
1974	1912	528.50	1909	691.20
1975	1913	574.00	1910	717.40
1976	1914	599.30	1911	763.90
1977	1915	630.10	1912	814.20
1978	1916	660.50	1913	856.50
1979	1917	680.00	1914	880.30
1980	1918	640.80	1915	910.10
1981	1919	601.30	1916	942.40
1982	1920	594.10	1917	850.20
1983	1921	613.50	1918	826.90
1984	1922	629.90	1919	792.30
1985	1923	643.40	1920	780.40
1986	1924	665.40	1921	802.20
1987	1925	689.90	1922	822.30
1988	1926	686.70	1923	838.60

[1] Man attains the specified age at beginning of year and retires then. Figures for attainments of age 62 in 1975 and after, and age 65 in 1978 and after, are also applicable to women; for earlier years in the table, the figures for women are somewhat higher. By "current monthly benefits" is meant the amount payable for January–November 1988.

APPENDIX TABLE 2.—ILLUSTRATIVE INITIAL CURRENT MONTHLY BENEFITS FOR MEN [1] WHO RETIRED IN VARIOUS YEARS AT AGE 62 OR AGE 65 WITH AVERAGE CREDITABLE EARNINGS IN ALL PREVIOUS YEARS

Year of attainment of age	Man retiring at age 62		Man retiring at age 65	
	Year of birth	Current benefit	Year of birth	Current benefit
1972	1910	$448.20	1907	$577.90
1973	1911	458.80	1908	587.50
1974	1912	477.20	1909	600.70
1975	1913	491.10	1910	613.90
1976	1914	501.00	1911	635.60
1977	1915	511.70	1912	656.80
1978	1916	525.30	1913	682.90
1979	1917	535.90	1914	700.10
1980	1918	503.10	1915	717.40
1981	1919	478.10	1916	741.50
1982	1920	468.50	1917	670.10
1983	1921	480.30	1918	644.40
1984	1922	489.20	1919	611.20
1985	1923	495.60	1920	596.70
1986	1924	509.00	1921	608.30
1987	1925	524.00	1922	618.40
1988	1926	517.90	1923	626.20

[1] Man attains the specified age at beginning of year and retires then. Figures for attainments of age 62 in 1975 and after and age 65 in 1978 and after are also applicable to women; for earlier years in the table, the figures for women are somewhat higher. By "current monthly benefits" is meant the amount payable for January–November 1988.

The deviation from the expected pattern of a gradual upward increase in the benefit amounts as the year of retirement becomes

later is largely the result of the benefits having risen more than planned because of the faulty computation method of the 1972 Act, followed by the effect of the resulting need to make a correction.

If this correction had been made without any transition provision, the benefits for those retiring at age 62 in 1979–80 would have been even lower than under present law, but then there would have been, more or less, the proper gradual upward trend in the *current* benefit for year of retirement 1979 up to year of retirement 1988. Specifically, the *current* benefit for maximum-earnings retirees at age 62 in 1979–83 would be as shown in Appendix Table 3 if only the AIME benefit computation procedure had been applicable.

APPENDIX TABLE 3.—COMPARISON OF CURRENT MONTHLY BENEFITS (PAYABLE FOR JANUARY–NOVEMBER 1988) UNDER AIME METHOD AND UNDER PRESENT LAW FOR VARIOUS YEARS OF RETIREMENT AT AGE 62 FOR PERSON WITH MAXIMUM CREDITABLE EARNINGS

Year of attainment of age 62	AIME method	Present law	Increase under present law
1978	N.A.	$660.50	
1979	$633.80	680.00	$46.20
1980	627.30	640.80	13.50
1981	601.30	601.30	
1982	594.10	594.10	
1983	613.50	613.50	
1984	629.90	629.90	
1985	643.40	643.40	
1986	665.40	665.40	
1987	689.90	689.90	
1988	686.70	686.70	

As shown by the first column, a decrease in the current benefit still appears during 1979–82, although it is a less precipitous one. It should be emphasized that this decline from 1979 to 1982 has nothing whatever to do with the notch problem per se. Instead, initial benefits under the AIME method fell then because of unusual economic conditions—prices rose much more rapidly than earnings (analysis of this phenomenon is given in footnote 4). Following year of retirement 1982, the expected pattern appears in the figures for the AIME method (and also for present law)—namely, a gradual increase generally (although a very small decrease for 1988).

Accordingly, that part of the apparent notch problem which is exemplified by the *current* benefits for persons born in 1917–20 being lower than for those born later is due to the planned increase in benefits as wages rise (which is a natural and proper result of the indexing method adopted in the 1977 Amendments). However, most of the notch problem—that part exemplified by the decrease in the *current* benefits for persons born in 1917–20 as against those born in 1916—is due to the windfalls given to those born before 1917 who worked long after age 62. Those windfalls were a result of the continuation of the application of the flawed benefit-computation method of the 1972 Act to their further earnings.

The result of making the necessary correction would have been an even larger notch in the benefits for age-62 retirees, as between

the 1916 and 1917–18 births if it had not been for the phase-in provisions adopted in the 1977 Act. Thus, many of those born in 1917–18 have been treated significantly better than pure theory would have called for when the flawed benefit-computation method under the 1972 Act was corrected in the 1977 Act. In other words, these individuals are better off than they would have been if the benefit-computation procedures in the 1972 Act had been proper ones (i.e. only the appropriate AIME procedure had been used). The real problem, thus, results from the windfalls which have occurred for those born before 1917 who worked beyond 1978 at substantial earnings.

As shown in Appendix Table 1, the *current* benefit for the maximum earner for retirement at age 65 increases sharply as the year of retirement becomes later than 1972—the effect of the faulty benefit-computation method introduced by the 1972 Act—until peaking for retirement in 1981 (year of birth 1916). Then, a sharp drop occurs for retirement in 1982 (year of birth 1917), with further decreases for the next three years of retirement (births in 1918–20), until again the anticipated slow rise occurs for each later year—reflecting the aforementioned long-run trend of benefit amounts under the Social Security program.

Thus, the presence of the notch is clearly indicated—but only for those born after 1916, particularly for those who worked well beyond age 62. Quite naturally, the notch is much larger for persons who continue to work at relatively high earnings and retire at ages later than age 65 than for those who retire at that age.

The same general results occur for the average-wage earner, as shown in Appendix Table 2. Once again, the trend appears that the *current* benefit rises sharply as the year of retirement becomes later, until year of retirement 1981. Then, there is a gradual fall until year of retirement 1985, and thereafter a steady increase occurs. Such a trend of benefits (expressed in 1988 dollars) will also occur for years after 1988 if real wages rise over the years.

Some persons who favor increasing benefits for those born in 1917–21 (and even some later years, such as up through 1928) support their arguments by considering figures like those in the last column of Appendix Table 2. But they consider only those born in about 1912–16 (retirements at age 65 in 1977–81) as having "proper" benefits, and they ignore what will be the case for those born after 1930 (retirements after 1995). They then propose to "fill in the gap" for the 1917–28 births at a level of benefits that would be at about the same *current* level as for 1911–13 births (but still below that of 1914–16 births).

Actually, the result of such proposals would be that persons born before 1911 (i.e., in the last column of Appendix Table 2, years of retirement before 1976) would be getting smaller benefits than those born later. The question might be raised whether persons with average earnings who retired at age 65 before 1976 should get less—as they do under present law and would continue to do under the proposals—than persons who retired at age 65 in, say, 1976 ($635.60) if persons who retired at age 65 in 1982–93 are to be raised to this level? It seems likely that, if this action were taken for those born in 1917 and after, then those born before 1911 would feel that they were inequitably treated and would demand benefit

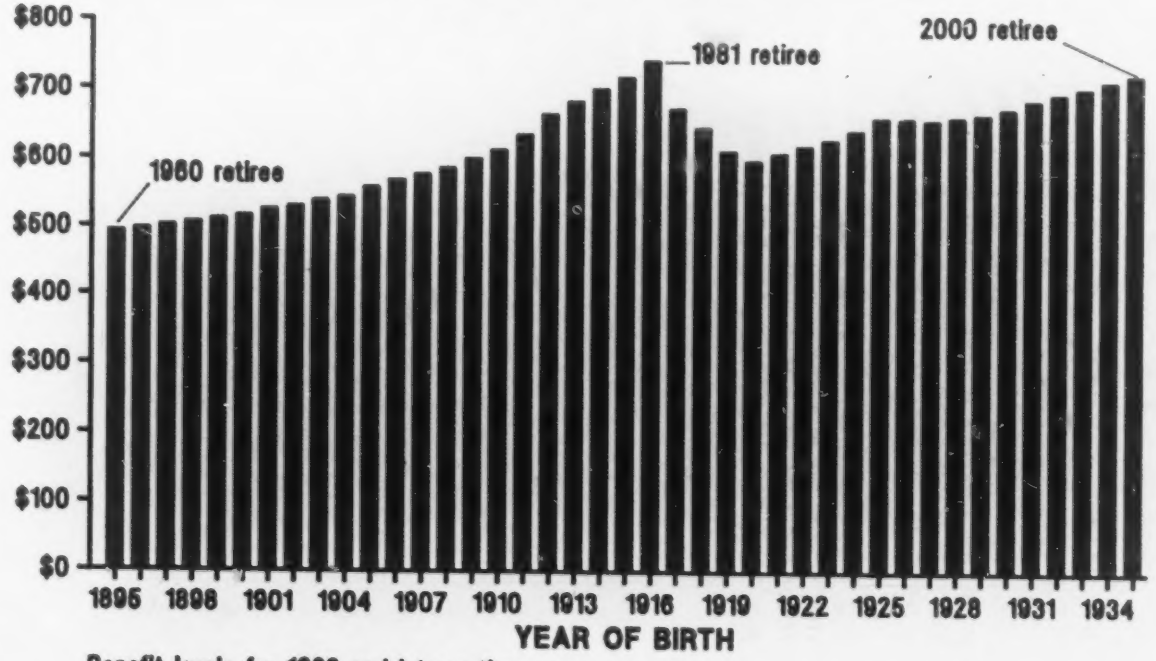
increases too. Later, when those born after 1928 retire at age 65 with higher levels of benefits, should there be costly changes made to increase all benefits for those born earlier?

The answer is, of course, "no" to benefit increases in both the foregoing cases, because it is the nature of the system to provide gradually increasing benefits for the same situation (as to retirement age and earnings level) as the years go by, assuming that a more or less steady growth in real wages occurs over the years.

Appendix Chart A depicts graphically the different current benefit amounts for retirees at age 65 who were born in different years. It is clear that those born in 1917–21 (or even a few years later) are not at a lower level than all other years of birth and that the benefits for all other years of birth are not all at the same level. In interpreting this chart, it should be kept in mind that it shows benefits received by persons retiring at age 65—when the notch is larger than for earlier retirement. Only a minority of workers currently postpone benefit application until age 65 or later.

CURRENT MONTHLY SOCIAL SECURITY BENEFITS FOR PERSONS BORN FROM 1895–1935 WHO HAD AVERAGE EARNINGS HISTORIES AND RETIRED AT AGE 65

(Benefit levels as of Jan. 1988)



Benefit levels for 1988 and later retirees are projected in constant 1988 dollars

Source: Congressional Research Service, March 1988

APPENDIX F—ILLUSTRATION OF METHOD OF BENEFIT COMPUTATION FOR PERSONS BORN BEFORE 1917 WHO WORKED AFTER 1978 WHICH WOULD HAVE ALLEVIATED THE NOTCH SITUATION IF IT HAD BEEN ENACTED IN 1977

(All page references are to item 8 in the Bibliography, Appendix C)

I. Assumptions

[a] Born in late December 1916 (age 65 in December 1981).
[b] Retires on December 31, 1981 (first benefit check for January 1982).
[c] Maximum creditable earnings in all years in 1951–81, with full-time employment throughout).

II. Benefit Computation Under 1972 Act (i.e., Present Law)

[a] Computation years—22 (i.e., 1978–1951–5).
[b] Highest 22 years—1960–81.
[c] Total earnings in highest 22 years—$248,300 (from page 125).
[d] Average Monthly Earnings—$248,300 : 22 x 12 = $940.
[e] PIA as of January 1979—$564.90 (from page 225, using [d]).
[f] PIA as of January 1982—$789.20 ([e] increased by COLA's of 9.9% for 1979, 14.3% for 1980, and 11.2% for 1981—see page 171).
[g] Benefit as of January 1982—$789.80 ([f] increased by Deferred-Retirement Credit of 1 month—.00083%).

III. Benefit Computation Under Possible Revised Method Which Should Have Been Enacted in 1977

(A) AME benefit based solely on earnings before 1979

[a] Computation years—22.
[b] Highest 22 years of actual earnings—1957–78.
[c] Total earnings in highest 22 years—$183,600 (from page 125).
[d] Average Monthly Earnings—$183,600 : 22 x 12 = $695.
[e] PIA as of January 1979—$481.20 (from page 225, using [d]).
[f] PIA as of January 1982—$686.40 ([e] increased by COLA's—see item II [f]).
[g] Benefit as of January 1982—$686.90 ([f] increased by DRC of .00083%).

(B) AIME benefit based solely on earnings before 1979

[a] Computation years—22.
[b] Highest 22 years of indexed earnings—all years in 1951–78, except 1954, 1958, and 1962–65.
[c] Total indexed earnings in highest 22 years—$291,246 (from page 167).

[d] AIME—$291,246 : 22 x 12 = $1,103.

[e] PIA as of January 1979—$454.30 (from page 77, using [d]).

[f] PIA as of January 1982—$634.70 ([e] increased by COLA's—see item II [f]).

[g] Benefit as of January 1982—$635.20 ([f] increased by DRC of .00083%).

(C) AIME BENEFIT BASED ON EARNINGS THROUGH 1981

[a] Computation years—22.

[b] Highest 22 years of indexed earnings—all years in 1951-81, except 1953-54, 1957-58, and 1961-65.

[c] Total indexed earnings in highest 22 years—$335,817 (from page 167).

[d] AIME—$335,817 : 22 x 12 = $1,272.

[e] PIA as of January 1979—$479.70 (from page 77, using [d]).

[f] PIA as of January 1982—$670.10 ([e] increased by COLA's—see item II [f]).

[g] Benefit as of January 1982—$670.60 ([f] increased by DRC of .00083%).

(D) INCREASE IN AIME BENEFIT FOR EARNINGS IN 1979-81

[a] Increase in AIME Benefit—$670.60-$635.20 = $35.40 (item [C][g], minus item [B][g]).

(E) TOTAL BENEFIT UNDER POSSIBLE REVISED METHOD

[a] Total benefit—$686.90 + $35.40 = $722.30 (item [A][g], plus item [D][g]).

APPENDIX G—SOCIAL SECURITY: TECHNICAL COMPARISON OF VARIOUS "NOTCH" BILLS INTRODUCED IN THE 100TH CONGRESS

	Current law	H.R. 1917 (Rep. Roybal)	H.R. 1721 (Rep. Daub); S. 1917 (Sen. Heinz)	H.R. 3788 (Rep. H. Ford); S. 1830 (Sen. Sanford)	S. 225 (Sen. D'Amato)
1. **Basic computation options for persons eligible during transition period:**	Higher of:				
	a. **Wage-indexed benefit** (computed from new formula); or	No change.	No change.	No change.	No change.
	b. **Transition guarantee benefit** (computed from old-law rules with various limitations).	Creates **another** set of transitional benefit-computation rules that can be used as an alternative to the existing rules. (In effect, the individual would get the higher of the wage-indexed benefit or either of **two** transition guarantees).	Creates **another** set of transitional benefit-computation rules that can be used as an alternative to the existing rules. (In effect, the individual would get the higher of the wage-indexed benefit or either of **two** transition guarantees).	Creates **another** set of transitional benefit-computation rules that can be used as an alternative to the existing rules. (In effect, the individual would get the higher of the wage-indexed benefit or either of **two** transition guarantees).	Existing transition guarantee rules would be liberalized.
2. **In order to use the transition guarantee rules, a worker must reach age 62 in:**	5-year period, 1979–83.	10-year period, 1979–88.	5-year period, 1979–83.	13-year period, 1979–91.	1979 and later (no ending point is defined).
3. **Who can receive the transition guarantee?**	Retired worker, dependent, and survivor, where worker on whose record the benefits are based was born in period from **1917–21.**	Retired worker, dependent, and survivor, where worker on whose record the benefits are based was born in period from **1917–26.**	Retired worker, dependent, and survivor, where worker on whose record the benefits are based was born in period from **1917–21.**	Retired worker, dependent, and survivor, where worker on whose record the benefits are based was born in period from **1917–29.**	Retired worker, dependent, and survivor, where worker on whose record the benefits are based was born after 1916 and had earned 27 quarters of coverage prior to 1979.

4. Major elements of the transition guarantee computation:					
a. Treatment of post-age 61 earnings:	Post-age 61 earnings cannot be used to determine average earnings.	Under the **newly-created** second set of transition rules, all earnings could be counted.	Under the **newly-created** second set of transition rules, three years' worth of post-age 61 earnings could be counted.	Under the **newly-created** second set of transition rules, four years' worth of post-age 61 earnings could be counted (but only up to $29,700/yr. after 1981 and only up though the year the person reached age 65).	Post-age 61 earnings could be counted under the liberalized transition rules (but only up to three additional years' worth after 1978, and only up to $29,700/yr. for years after 1981).
b. Treatment of pre-age 62 COLAs in computing initial benefits:	Pre-age 62 COLAs after 1978 are **not** counted.	Under the **newly-created** second set of transition rules, all pre-age 62 COLAs could be counted.	Under the **newly-created** second set of transition rules, all pre-age 62 COLAs could be counted	Under the **newly-created** second set of transition rules, all pre-age 62 COLAs could be counted	All pre-age 62 COLASs could be counted under liberalized transition rules.
c. Number of years of highest earnings used to determine average earnings:	Same as under "old law" and "wage-indexing" computation rules: 35 years for persons becoming eligible in 1991 and later (progressively fewer for persons who become eligible prior to 1991; e.g., 25 years for persons becoming eligible in 1981).	Same as current law.	Same as current law.	Same as current law.	Averaging period could not exceed 25 years.

APPENDIX G—SOCIAL SECURITY: TECHNICAL COMPARISON OF VARIOUS "NOTCH" BILLS INTRODUCED IN THE 100TH CONGRESS—Continued

	Current law	H.R. 1917 (Rep. Roybal)	H.R. 1721 (Rep. Daub); S. 1917 (Sen. Heinz)	H.R. 3788 (Rep. H. Ford); S. 1830 (Sen. Sanford)	S. 225 (Sen. D'Amato)
4. Major elements of the transition guarantee computation:—Cont.					
d. Other factors affecting the size of transition guarantee benefits:	None.	Benefits computed under the **newly-created** second set of transition rules would be reduced by 6% for workers born in 1917 and by progressively larger amounts for workers born in later years (the reduction factor increases by 3% a year until it reaches 33% for workers born in 1926).	A percentage of the difference between the **newly-created** transition benefit and the amount computed under wage-indexing rules would be added to the wage-indexed benefit. (The percentage declines with each new cohort in the 1917–21 birth groups). If this new two—tiered benefit is higher than under current law, it becomes the new guarantee.	Benefits computd under the **newly-created** sedcond set of transition rules would be reduced by 7% for workers born in 1917 and by progressively larger amounts for workers born in later years (the reduction factor increases by 2% a year until it reaches 31%). The reduction factor increases further by 1% a year (1/12% a month) when retirement is delayed beyond age 62 (up to another 3%). The maximum reduction is thus 34% (31% plus 3% for workers born in 1929).	None.

5. **Other features of the bills:**	No benefit could be reduced as a result of any recomputation caused by revision of the transition rules.		No recomputation of benefits would be permitted for earnings in years after a person reaches age 70, if the person became eligible prior to 1979. The limitation could not result in a reduction of existing benefits.	No benefit could be reduced as a result ot a recomputation caused by revision of the transition rules for any month prior to January 1985.
6. **Retroactive payments under the bills:**	If higher benefits result from using new transition rules, retroactive payments would be made back to point ot initial entitlement (to 1979 in some cases).	None.	If higher benefits result from using new transition rules, retroactive payments would be made back to point of initial entitlement (to 1979 in some cases), not to exceed $1,000 but no less than $300 per person in the event of family payments that exceed $1,000 (with respect to payments for months before January 1987).	If higher benefits result from using new transition rules, retroactive payments would be made back to point of initial entitlement (to 1979 in some cases for retired workers, but no earlier than January 1985 for family members).
7. **Effective date of changes:**	Upon enactment, with retroactivity back to point of initial entitlement.	For monthly benefits beginning in January 1988.	Upon enactment, with retroactivity back to point of initial entitlement.	Upon enactment, with retroactivity back to point of initial entitlement.

APPENDIX G—SOCIAL SECURITY: TECHNICAL COMPARISON OF VARIOUS "NOTCH" BILLS INTRODUCED IN THE 100TH CONGRESS—Continued

	Current law	H.R. 1917 (Rep. Roybal)	H.R. 1721 (Rep. Daub); S. 1917 (Sen. Heinz)	H.R. 3788 (Rep. H. Ford); S. 1830 (Sen. Sanford)	S. 225 (Sen. D'Amato)
8. Cost of bills:					
a. Short range:					
Calendar year:					
1988		$21.1 billion	$2.2 billion	$14.0 billion	$54.9 billion
1989		6.5	2.6	5.3	18.8
1990		7.3	2.7	5.9	22.2
1991		7.9	2.8	6.4	25.7
1992		8.3	2.8	6.8	29.2
1993		8.5	2.8	7.1	32.7
1994		8.7	2.8	7.3	36.3
1995		8.9	2.8	7.4	39.8
1996		9.0	2.8	7.4	43.3
Total 1988–96		$86.9	$24.3	$67.5	$302.8
b. Long range:					
Cost expressed as percent of taxable payroll:		0.08% (Equivalent to **$1.6** billion per year for the next 75 years, when measured against the level of taxable payroll in 1988).	0.02% (Equivalent to **$0.4** billion per year for the next 75 years, when measured against the level of taxable payroll in 1988).	0.07% (Equivalent to **$1.4** billion per year for the next 75 years, when measured against the level of taxable payroll in 1988).	0.035% (Equivalent to **$7.1** billion per year for the next 75 years, when measured against the level of taxable payroll in 1988).

Source: Social Security Administration, Office of the Actuary, February 1988. All estimates are based on the Intermediate II–B assumptions of the 1987 Old Age, Survivors, and Disability Insurance (OASDI) Trustees' Report, with the exception of the long-range cost of S.225 (Senator D'Amato), which is based on the Intermediate II–B assumptions of the 1986 OASDI Trustees' Report.

STATEMENT BY SENATOR LARRY PRESSLER
BEFORE THE
SENATE SUBCOMMITTEE ON SOCIAL SECURITY AND
FAMILY POLICY OF THE SENATE COMMITTEE
ON FINANCE

HEARING ON
SOCIAL SECURITY NOTCH

JANUARY 22, 1989

MR PRESSLER: MR. CHAIRMAN, I WANT TO THANK YOU FOR THIS OPPORTUNITY TO APPEAR BEFORE THE SUBCOMMITTEE ON SOCIAL SECURITY AND FAMILY POLICY OF THE SENATE COMMITTEE ON FINANCE. AS YOU KNOW SOCIAL SECURITY NOTCH IS VERY IMPORTANT TO ME BECAUSE IT AFFECTS 9 MILLION RETIRED AMERICANS AMONG WHICH ARE SOME 15,000 SOUTH DAKOTANS. IT IS A CONCERN WHICH MY CONSTITUENTS CONTINUE TO ADDRESS IN THEIR MAIL.

THE HISTORY OF THE NOTCH DATES TO 1972 WHEN CONGRESS AMENDED THE SOCIAL SECURITY ACT TO PROVIDE FOR ANNUAL COST-OF-LIVING ADJUSTMENTS. THAT DECISION RESULTED IN INCREASING THE FUTURE BENEFITS OF CURRENT WORKERS TWICE: ONCE THROUGH A COST-OF-LIVING LVING ADJUSTMENT (COLAS) IN THE SOCIAL SECURITY BENEFITS AND AGAIN BECAUSE OF THE INFLATION-BASED GROWTH. AS A RESULT OF THE 1972 AMENDMENT, SOME INDIVIDUALS RETIRING BY THE YEAR 2000 WOULD RECEIVE MONTHLY BENEFITS GREATER THAN THEIR WORKING SALARIES.

SOCIAL SECURITY BENEFITS WERE INCREASING AT RATES FASTER THAN WAS INTENDED BY CONGRESS BECAUSE THE FORMULA OVER-COMPENSATED FOR INFLATION. THE 1972 AMENDMENT, IF LEFT UNCHECKED, MAY HAVE BANKRUPTED THE SOCIAL SECURITY SYSTEM. CONGRESS IN 1977 APPROVED A PLAN TO ELIMINATE THE OVERADJUSTMENT FOR INFLATION BY PROVIDING FOR A NEW BENEFIT FORMULA FOR WORKERS BORN AFTER 1916. THIS AMENDMENT INCLUDED A TRANSITION FORMULA TO PROTECT PEOPLE FROM AN ABRUPT CHANGE IN BENEFITS. THE TRANSITION FORMULAE DIVIDED SOCIAL SECURITY BENEFICIARES INTO THREF CATEGORIES: THOSE BORN BEFORE 1917, THOSE BORN BETWEEN 1917 AND 1921--THE NOTCH YEARS --AND THOSE BORN AFTER 1921.

THE TRANSITION FORMULAE WERE EXPECTED TO BE 5 TO 7 PERCENT LESS THAN THOSE PROJECTED TO BE PAID UNDER THE 1972 LAW. HOWEVER, THE FORMULAE FAILED. INSTEAD, WORKERS WITH THE SAME EARNING RECORD, RETIRING AT THE AGE OF 65, AND BORN ONLY A FEW DAYS APART, ONE IN 1916 AND THE OTHER IN 1917, EXPERIENCED UP TO $1,300 PER YEAR DIFFERENCE IN RECEIVED BENEFITS.

A MAJOR REASON FOR THE FORMULA FAILURE WAS THE THE HIGH RATE OF INFLATION IN THE LATE 1970S. ANOTHER REASON OF EVEN GREATER IMPORTANCE IS THAT THE POST-AGE 82 EARNINGS OF THE PEOPLE BORN AFTER 1916 ARE EXCLUDED WHEN CALCULATING THE BENEFITS FOR WORKERS BORN IN THE NOTCH YEARS.

THE PEOPLE WHO ARE 'NOTCH BABIES' FEEL THE WEIGHT OF DISCRIMATION AND INEQUITY WHICH RESULTS FROM THIS POLICY CHANGE EVERY TIME THEY RECEIVE THEIR MONTHLY SOCIAL SECURITY CHECKS. A CHANGE IS NEEDED TO INCREASE NOTCH BABIES' PAYMENTS TO A LEVEL EQUAL TO OTHER RETIREES.

I RECOGNIZE THAT THIS RECOMMENDATION IS NOT IN AGREEMENT WITH THAT SET FORTH IN THE STUDY BY THE NATIONAL ASSOCIATION OF SOCIAL INSURANCE. THIS REPORT STATES THAT NOTCH WAS CREATED BY VIRTUE OF THE 1972 AND 1977 AMENDMENTS AND THAT IT IS "UNDESIREABLE AND UNFORTUNATE." HOWEVER, BASED ON THE ANALYSIS IN THE REPORT, THE CONCLUSION IS NO REAL INEQUITIES EXIST! I STRONGLY DISAGREE. THE REPORT OUTLINES A COMPARISON BASED ON ONLY TWO YEARS: A PERSON BORN IN 1916 COMPARED WITH SOMEONE BORN IN 1917, ASSUMING SIMILAR EARNINGS FOR EACH. WHAT ABOUT SOMEONE BORN IN 1916 COMPARED WITH SOMEONE BORN IN 1920? FURTHER, WHAT ABOUT THOSE WHOSE EARNINGS ARE NOT COMPARABLE? IT WOULD APPEAR THAT OTHER INFORMATION IS NECESSARY PRIOR TO CONCLUDING THAT THERE EXISTS NO ECONOMIC INEQUITY FOR THOSE BORN IN THE NOTCH YEARS. THE "NOTCH BABIES" HAVE BEEN DISCRIMINATED AGAINST FAR TOO LONG. LET'S MOVE FORWARD QUICKLY TO CORRECT THIS

GROSS INEQUITY. LET'S FACE UP TO THE PROBLEM RATHER THAN FALLING BACK ON ONE STUDY AFTER THE NEXT, WHICH IN THE END WILL NOT RESOLVE THE PROBLEM.

AGAIN, I THANK YOU, MR. CHAIRMAN, FOR HOLDING THIS IMPORTANT HEARING TODAY ON THE SOCIAL SECURITY NOTCH. I LOOK FORWARD TO A PROMPT RESOLUTION TO THIS PROBLEM WHICH AFFECTS THE INTERESTS OF SO MANY OF OUR NATION'S ELDERLY.

Chart 1

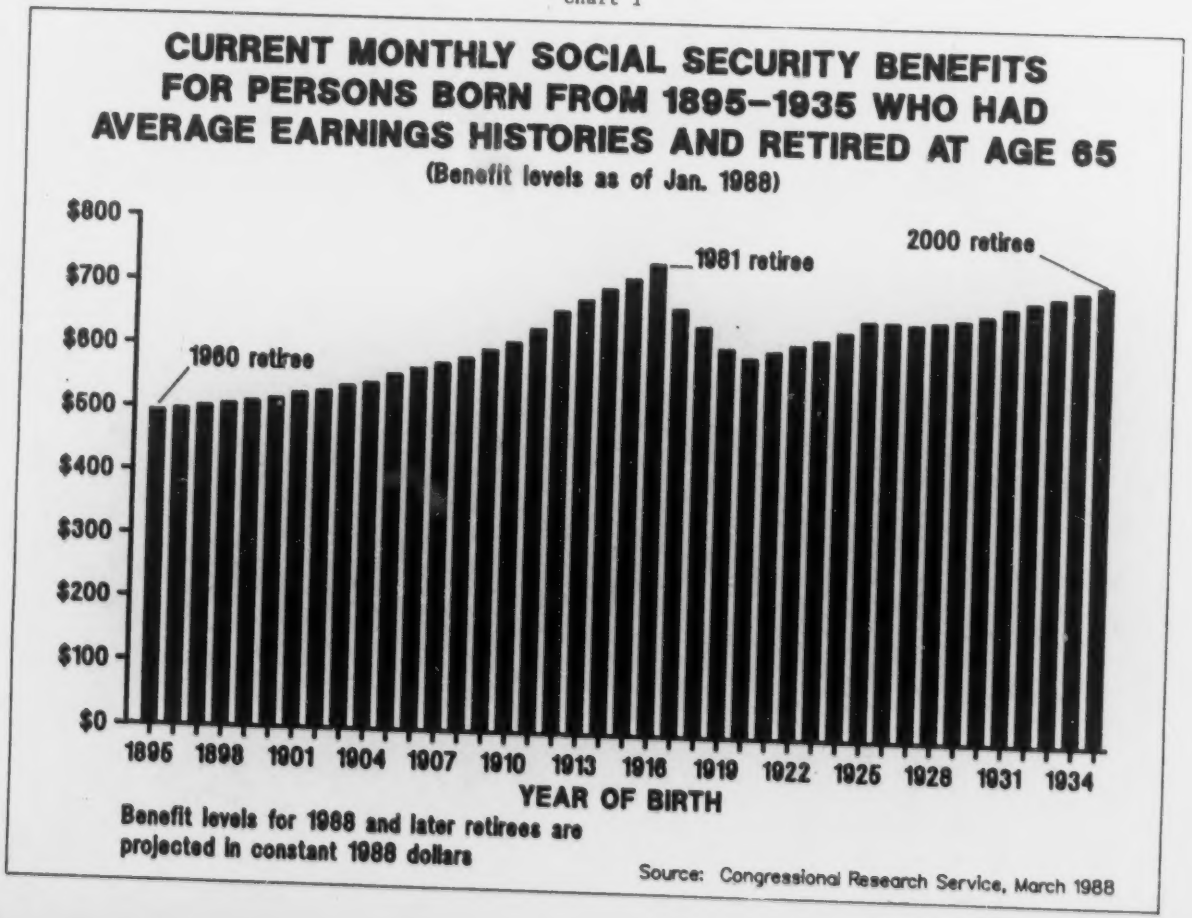
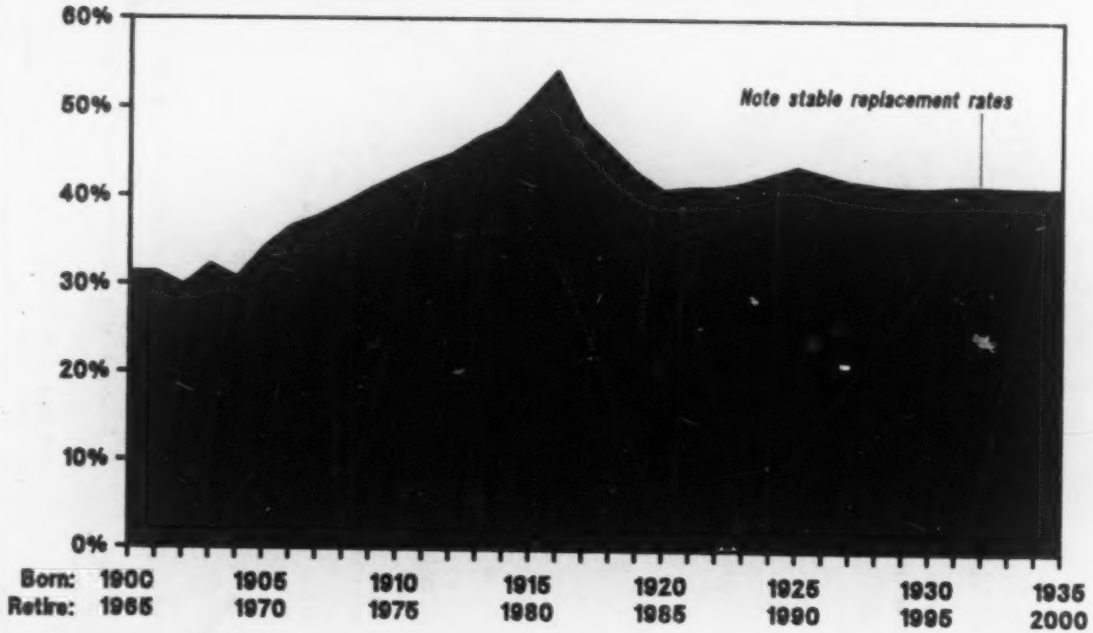

CURRENT MONTHLY SOCIAL SECURITY BENEFITS
FOR PERSONS BORN FROM 1895–1935 WHO HAD
AVERAGE EARNINGS HISTORIES AND RETIRED AT AGE 65
(Benefit levels as of Jan. 1988)
$800
$700
$600
$500
$400
$300
$200
$100
$0
1960 retiree
1981 retiree
2000 retiree
1895 1898 1901 1904 1907 1910 1913 1916 1919 1922 1925 1928 1931 1934
YEAR OF BIRTH
Benefit levels for 1988 and later retirees are
projected in constant 1988 dollars
Source: Congressional Research Service, March 1988

Chart 2

REPLACEMENT RATES (PERCENTAGES OF FINAL YEAR'S EARNINGS) PAYABLE TO WORKERS RETIRING IN VARIOUS YEARS AT AGE 65, HAVING HAD AVERAGE EARNINGS DURING THEIR CAREERS



Source: Office of the Actuary, Social Security Administration, January 27, 1988.

Chart 3

ILLUSTRATIVE REPLACEMENT RATES FOR MEN[a] WITH AVERAGE EARNINGS WHO RETIRED IN VARIOUS YEARS

Year of Attainment of Age	Retiring at Age 62	Retiring at Age 65
1972	27.4%	35.3%
1973	30.7	39.2
1974	30.0	37.8
1975	32.4	40.4
1976	33.2	42.1
1977	33.7	43.3
1978	34.6	45.0
1979	34.8	45.5
1980	33.1	47.1
1981	33.0	51.1
1982	32.6	46.6
1983	34.0	45.7
1984	34.2	42.7
1985	33.9	40.8
1986	34.4	41.1
1987	34.8	41.1
1988	34.3[b]	41.4[b]

a) Man attains the specified age at beginning of year and retires then. Figures for attainments of age 65 in 1978 and after are also applicable to women; for earlier years in the table, the figures for women are somewhat higher.

b) Figure for average wage for 1987 is taken from 1988 Trustees Report.

Chart 4

ILLUSTRATIVE INITIAL MONTHLY BENEFITS FOR PERSONS BORN IN LATE 1916 AND EARLY 1917 WHO HAVE SAME EARNINGS RECORD AND RETIRE ON SAME DATE

Date of Retirement	Average-Wage Earner			Maximum-Wage Earner		
	Born in 1916	Born in 1917	Difference	Born in 1916	Born in 1917	Difference
January 1979	$312	$306	$ 6	$ 395	$ 388	$ 7
January 1980	388	365	23	493	463	27
January 1981	500	449	51	635	570	65
January 1982	623	535	88	789	679	110
January 1983	716	592	124	900	755	145
January 1984	773	638	135	990	826	164
January 1985	834	691	143	1,084	904	180
January 1986	894	747	147	1,178	985	193
January 1987	937	794	143	1,255	1,056	199

Note: Figures rounded down to exact dollars (when not already an exact dollar).

Chart 5

ILLUSTRATIVE MONTHLY BENEFITS FOR PERSONS BORN IN LATE 1921 AND EARLY 1922 WHO HAVE SAME EARNINGS RECORD AND RETIRE ON SAME DATE

	Average Earners			Maximum Earners		
Date of Retirement	Born in 1921	Born in 1922	Difference	Born in 1921	1922	Difference
January 1984	$430	$437	$ 7	$556	$559	$ 3
January 1985	484	488	4	632	635	3
January 1986	541	544	3	713	715	2
January 1987	589	593	4	785	789	4

Chart 6

ILLUSTRATIVE MONTHLY BENEFITS FOR PERSONS BORN IN LATE 1916 UNDER WHAT WOULD HAVE BEEN PROPER PROCEDURE AND FOR PERSONS BORN IN EARLY 1917 UNDER PRESENT LAW WHO HAVE SAME EARNINGS RECORD AND RETIRE ON SAME DATE

	Average-Wage Earner			Maximum-Wage Earner		
Date of Retirement	Born in 1916	Born in 1917	Difference	Born in 1916	Born in 1917	Difference
January 1979	$312 (312)	$306	$ 6	$395 (395)	$388	$ 7
January 1980	374 (388)	365	9	477 (403)	463	14
January 1981	464 (500)	449	15	597 (635)	570	27
January 1982	557 (623)	535	22	722 (789)	679	43
January 1983	613 (716)	592	21	793 (900)	755	38
January 1984	651 (773)	638	13	859 (990)	826	33
January 1985	693 (834)	691	2	922 (1084)	904	18
January 1986	723 (894)	747	-5	969 (1178)	985	-16
January 1987	767 (937)	794	-27	1049 (1255)	1056	-7

Note: Figures in parentheses are benefits under 1972-Act basis (i.e., present law). The difference between such figure and the figure to its left represents the portion of the notch which is due to the windfall resulting for persons born before 1917 who work well beyond age 62 (after 1978).

Note: Figures rounded down to exact dollars (when not already an exact dollar).

The Social Security Notch

Statement of

Eric Shulman
Director, Legislative Liaison and Research

National Council of Senior Citizens

before the

Committee on Finance
Subcommittee on Social Security.

January 23, 1989

Washington, D.C.

Chairman Moynihan, members of the Subcommittee, I am Eric Shulman, Legislative Director of the National Council of Senior Citizens. I appreciate the opportunity to appear today to discuss the issue of the Social Security "notch."

I want to begin by praising the effort of the National Academy on Social Insurance which has done an excellent job in explaining the highly complex and technical issue of the notch. I sincerely hope this report will help to dispel some of the unfortunate misconceptions that are widely held on this issue.

As an organization representing 4.5 million members in local clubs around the country, NCSC has been and will continue to be a staunch advocate of Social Security. No single program has done more to protect senior citizens from the ravages of poverty and inflation in their older years. It is our belief that protecting the future of Social Security depends upon two equally important, fundamental principles. First, the fiscal soundness of the system must be maintained for current and future beneficiaries. Second, public support for Social Security must continue.

Unfortunately, the issue of the Social Security "notch" threatens to undercut the foundations of both these principles.

History of the Notch

As the National Academy report makes clear, the notch issue

developed from Social Security amendments enacted in 1972 and 1977. The 1972 amendments provided, for the first time, automatic indexing of Social Security benefits for inflation. This measure achieved an important social goal of alleviating poverty among the elderly. At the time, poverty among the aged was nearly double that of all other age groups; now it is on a par with that of the overall population.

Unfortunately, an unintended flaw in the new system of indexing, combined with the unforeseen inflation of the 1970s, resulted in benefit increases far in excess of what had been intended. Essentially, retirees were receiving dual compensation for the effects of inflation and some projections indicated that, ultimately, wage replacement rates could have exceeded 100 percent of earnings.

Most important, this flaw in the formula, if left unchanged, would have threatened the financial stability of the Social Security system. Without revision of the benefit formula, escalating expenditures could have led to bankruptcy of the system or prohibitive payroll tax rates, perhaps as high as 20 percent.

Hence, the 1977 amendments were designed in order to eliminate the over-indexing of benefits and stabilize the replacement rates. Understanding the concept of replacement rates is critical to a grasp of the notch issue.

Social Security does not provide more than a floor of benefits, which must be supplemented by pension income and savings. Recognizing that lower-paid workers are less able to save for their retirement, the system replaced a higher proportion of the wages for low-wage earners. This achieved a deliberate social goal of addressing both social adequacy and individual equity.

The purpose of the 1977 amendments was to reduce and stabilize the replacement rate, so that retirement benefits would replace a predictable proportion of average annual

lifetime earnings. The amendments also intended to safeguard the financial stability of the Social Security trust funds without inequitably burdening any group of workers.

The crafters of the 1977 amendments recognized that there would be a disparity in benefit levels with the implementation of the new benefit formula. They attempted to lessen its magnitude by instituting a five-year transition period. These transition years pertain to persons born between 1917 and 1921 and are now referred to as the notch years.

Persons born in the transition years have their benefits calculated twice--using both a transitional formula and the new formula. Their benefit level is the higher of the two. As an earlier report by the Government Accounting Office (GAO) points out, the replacement ratios of persons in the transition, or notch, years actually ended up being somewhat higher than originally anticipated.

But what was even more dramatic was the enormous increases received by persons in the pre-transition years. The impact of inflation on the old, flawed, formula yielded exceptionally high replacement rates. The juxtaposition of wildly inflated benefits and the more appropriate, revised benefits led to the perception of an unfair disparity.

This issue began to receive wide public attention when these complex and technical issues were oversimplified in two "Dear Abby" columns. The columns left readers with misleading and erroneous information and the damaging public perception that Social Security had arbitrarily penalized one group of retirees.

Looking only at certain notch examples, which show two persons with similar work histories receiving substantially different benefit levels, due to an accident of birth, would strike anyone as being unfair. But as the GAO report so aptly states, "The clarity of examples that illustrate the notch

contrast rather sharply with the complexity of factors underlying the problem."

What is ironic is that the supposedly maligned "notch babies" receive benefit levels as intended by Congress. The "injustice" is that persons in the pre-transition years, sometimes called "bonanza babies" receive significantly higher benefits than ever intended.

Congress deliberately chose not to revoke the excess benefits of the bonanza babies, feeling that they should not be penalized for an unintended error in the formula. What was not foreseen was the perhaps inevitable confusion of persons who just barely missed out on this windfall.

Maintaining the Fiscal Solvency of Social Security

Surely the notch issue seems to be governed by the "Law of Unintended Consequences." Created out of deep concern for the long-term financial security of the Social Security system, this issue has now spawned a host of legislative "solutions" which, in our view would only serve to worsen the problem.

The notch legislation receiving the greatest attention would result in a loss to the Social Security Trust Funds in the range of $70-$85 billion, over ten years. There is no question that such legislation would adversely affect the system's attainment of minimum contingency reserve levels. Further, in the event of an economic downturn, which many predict in the near future, these notch proposals would again put the system at serious risk.

Significantly, none of the legislative notch proposals provide for replacement of the billions of dollars that would be drained from the Trust Funds. Congress has already rejected recouping the "bonanza babies'" windfall. The only option left would be to impose higher payroll taxes on current workers, or reducing benefits for all recipients.

This would constitute a serious inequity for today's workers who already pay higher payroll taxes to partially fund

future benefits and who would receive lower replacement rates than the notch babies for whom they would pay still higher taxes. In addition, if the notch babies are given higher benefits, succeeding retirees will then feel they have been unjustly penalized, creating a new notch, and an endless problem.

NCSC could not support legislation which would threaten to jeopardize the financial stability of the Social Security system. Social Security is our nation's finest social policy success upon which nearly all Americans will one day rely. Nothing must be allowed to imperil its economic foundation.

Maintaining Public Support for Social Security

Public opinion polls have consistently shown broad public support for Social Security. NCSC is concerned that, if the notch issue is not handled properly, it could jeopardize this support in two ways.

First, as the GAO report so aptly stated, "No amount of technical discussion and sophisticated analysis is sufficient to convince an individual that it is equitable for him to receive a benefit that is $100 less per month than his nearly identical neighbor." If the system begins to be widely perceived as unfair, support for it will surely falter.

On the other hand, it is abundantly clear that the "notch babies" in fact are not receiving lower benefits that is appropriate. Many receive higher replacement rates than many other Social Security recipients. Furthermore, those who experience the largest disparities vis a vis the "bonanza babies" tend to have higher relative income and assets. Consequently, if Congress is perceived as caving in to the illegitimate demands of one segment of the beneficiary population, at the cost of increased burdens on others, this too would likely undercut support for the Social Security system.

Already, many in the media are quick to declare that the elderly are greedy, that they get more than they deserve while child poverty increases. NCSC and its members have always stood

for an America which is responsive and fair to all its vulnerable citizens, regardless of age. We have consistently tried to work constructively with the Congress to address problems facing the elderly. We would regret action being taken on the notch issue which could have the unintended result of weakening support for Social Security.

We are also deeply concerned that the current proposals which purport to correct the notch would simply perpetuate the problem. If benefits are increased for this cohort, succeeding retiree groups will then undoubtedly feel that their benefits are too low. Where would the cycle end?

Recommendations

NCSC believes it would be extremely helpful if the Administration and Congress could join with organizations like ours to conduct a massive public education effort. We would like to see all Social Security recipients receive an official statement from SSA, in clear and understandable language, explaining the notch issue. This could do much to dispel the perception of unfairness in the Social Security system.

It is critical, both for reasons of fiscal prudence and public perception, that Congress consider the deleterious impact that could result from ill-conceived notch legislation. Futhermore, we regret that the notch situation deflects attention from pressing issues, such as long-term care and poverty among the elderly, which constitute far more serious problems for older persons and their families.

I thank you again for the opportunity to speak today and will be glad to answer any questions you may have.

STATEMENT OF

THE HONORABLE BRUCE SUMNER

FOR THE

NATIONAL COMMITTEE TO PRESERVE
SOCIAL SECURITY AND MEDICARE

REGARDING

CORRECTION OF THE SOCIAL SECURITY NOTCH

JANUARY 23, 1989

I am Bruce Sumner, a member of the Board of Directors of the National Committee to Preserve Social Security and Medicare. Since I began service on the board in 1987, the Notch has been one of the highest priorities of our members. The National Committee has lobbied hard to find a compromise to this problem that will balance our members' concern for benefit equity with Congress concern for fiscal responsibility. Unfortunately, the flawed and biased report by the study panel of the National Academy of Social Insurance provides the Committee little assistance in finding a solution to this problem.

Despite the two recent studies, one by the National Academy and one by the General Accounting Office, the best, most objective study to date was published by the American Enterprise Institute in 1985 when they examined Proposals to Deal with the Social Security Notch Problem. While four years old, the Committee could still learn from a review of this study and I request that you make it a part of the record.

The National Committee is the only organization here today to testify in favor of correcting the Notch. I understand that a number of organizations wanted to testify or would have wanted to testify if they had known about the hearing in time. These organizations, like the Gray Panthers, the Veterans of

Foreign Wars, the Jewish War Veterans and the American Bar Association, wanted to testify in favor of correcting the Notch. It is clear that the Notch is an issue that affects many seniors who are members of these organizations and are even members of the other two senior organizations testifying today. We protest that these organizations were not given an opportunity to represent their members before the Senate Finance Committee.

CONGRESSIONAL INTENT

Mr. Chairman, the first failure of this report is that it does not discuss what you and your colleagues intended in the 1977 Social Security Amendments. Even then your Committee had to balance cost and equity, but the record is clear: Congress intended a gradual, almost imperceptible transition to the new benefit formula, not the abrupt, approximately 20 percent reduction that actually occurred.

Senator Nelson, your predecessor as Subcommittee chairman, summed up the Committee's work by saying:

> We felt that American workers would be willing to pay additional tax dollars if they could be assured that their parents and grandparents would continue to receive their monthly benefit checks and if they could be assured that *the benefits to which they are entitled would not be diminished in the future* (Congressional Record, November 2, 1977, p. 36481-2). Italics added.

In explaining the technical benefit changes, Senator Nelson said that:

> Decoupling by itself...would also cause a significant reduction in the real value of future benefits. In order to forestall a reduction of this nature, the committee bill would provide that future benefits be based on 'indexed' earnings rather than the actual earnings that are used under the present law.
>
> A basic change such as that which would be provided by the committee bill also requires many substantial changes in provisions of present law, transitional provisions for the period during which the new system is implemented, and a number of conforming amendments to minimize possible disruptions that so basic a change in the benefit structure might otherwise produce. (Congressional Record, November 2, 1977, p. 36480)

The table accompanying this explanation in the Congressional Record shows no drop in benefits. Instead, it shows that a worker with average earnings retiring in 1985 would have $267 more in annual benefits than a similar worker who retired in 1979. This chart did not have year-by-year benefit estimates. See Appendix A for complete documentation on Congressional intent.

TABLE 7.—BENEFITS, REPLACEMENT RATES, AND EXPENDITURES UNDER COMMITTEE BILL, 1979–2050

(In percent)

Year	Worker with average earnings[1]		Replacement rate for worker with—		Aggregate OASDI expenditures	
	Annual benefit in 1977 prices	Replacement rate	Low earnings[2]	High earnings[3]	As percent of payroll	As percent of GNP[4]
1979	$ 54, 444	46	58	35	10.24	4.2
1985	6, 711	43	54	30	10.54	4.3
1990	5, 144	43	55	30	10.83	4.5
1995	5, 560	43	54	30	11.09	4.6
2000	6, 067	43	54	31	11.31	4.6
2010	17, 171	43	54	32	12.47	5.1
2020	8, 472	43	54	32	15.24	6.3
2030	10, 011	43	54	32	17.32	7.1
2040	11, 630	43	54	32	16.84	6.9
2050	13, 976	43	54	32	16.38	6.7

	Percent
Average medium-range cost (1977–2051)	10.91
Average medium-range revenue	11.05
Average medium-range deficit	+0.05
Average long-range cost (1977–2051)	13.00
Average long-range revenue	13.05
Average long-range deficit	+.05

[1] Assumed to be 4 times the average 1st quarter covered earnings.
[2] Assumed at $4,600 in 1976 and following the trends of the average.
[3] Assumed at the maximum taxable under the program.
[4] For 1979 and later, based on full employment and assuming taxable payroll equals 41.1 percent of GNP.
[5] Based on the present law benefit formula for all workers attaining age 62 before Jan. 1, 1979 (as in H.R. 9210).

Note: The estimates in this table are based on the economic and demographic assumptions used in the intermediate cost estimates (alternative II) in the 1977 OASDI Trustees Report. The replacement rates pertain to workers with steady employment at increasing earnings and represent the annual retirement benefit at age 65 over the earnings in the year immediately prior to retirement.

Source: Congressional Record, November 2, 1977, p. 36480.

TIME FOR A DECISION

Mr. Chairman, I am a retired California judge and legislator. I currently arbitrate many private disputes. I know what your job is like and how hard it is to make decisions that affect people's lives. In my profession, there are times that I wish that I could avoid making those decisions, but that is my job. Social Security Notch victims are bringing their request before your "court" and are asking for the Senate and this Congress to vote on a solution to this problem. This is in some ways akin to presenting a case before a jury and a jury has no choice but to render a decision on the issue before it.

To help you make that decision, you asked the National Academy of Social Insurance to "identify all options and analyze the impact on Social Security beneficiaries and taxpayers and the old-age and survivors insurance

trust fund." Such an analysis of all options would have helped you weigh the pros and cons and design an appropriate solution. But because the study panel decided not to analyze the options, you do not have the benefit of its advice.

The National Academy's recommendation to do nothing does not solve the central political issue which was posed by the General Accounting Office on p. 90 of its March, 1988, report: "No amount of technical discussion and sophisticated analysis is sufficient to convince an individual that it is equitable for him to receive a benefit that is $100 less than his nearly identical neighbor." And the study panel report concedes that the "notch situation is undesirable and unfortunate." (NASI, p. 1) This issue cannot be simply explained away. Rather than do nothing as the study panel recommends, the National Committee believes that the solution lies in going back to Congress' original 1977 intent which was a gradual transition resulting in an almost imperceptible reduction in benefits.

Finding a solution is in the best interest of Congress, the Social Security system and the nation. We need to stop undermining public confidence in the Social Security system. Mr. Chairman, we stand behind your legislative efforts to restore confidence in the Social Security system by creating an independent agency, by requiring annual earnings statement and benefit estimates for all workers and by protecting trust funds from misuse for deficit reduction. But we are concerned that you and your colleagues have underestimated the damage to the integrity of the Social Security system that the Notch and the failure to correct it has caused.

Your decision is not an easy one, but it is not impossible to find a reasonable solution. The National Committee did not always support a solution to the Notch. At first we also heeded those "experts" who said that the problem did not exist. But the flood of letters and comments from our members, our own analysis and the urging of Members of Congress

eventually convinced us that these experts were as wrong as they could be. The National Committee decided in 1986 to support legislation which had been first introduced in 1983 by Rep. Edward Roybal, chairman of the House Select Committee on Aging.

The original Roybal legislation, which is similar to legislation introduced by Senator D'Amato in the 100th Congress, was very expensive. But we worked with grassroots leaders and Members of Congress to design a compromise solution which responded to Congressional worries about the impact of the cost on the Trust Funds. Senator Sanford introduced this legislation in the 100th Congress and it garnered bipartisan support. We proved that a compromise can be fashioned. But if Senator Sanford's proposal is not the ideal compromise, tell us what is.

FLAWED FINDINGS

I want to now focus on our differences with the report and why we think it is flawed. But let me begin by enumerating areas on which we agree and over which we do not have to debate. All of us agree that:

- The benefit formula in 1972 was flawed and needed to be corrected.
- It was necessary for Congress in 1977 to lower and stabilize replacement rates for future beneficiaries, though we think the record shows that Congress intended a target replacement rate of at least 43% rather than 41%.
- The "notch situation is undesirable and unfortunate." (NASI, p. 1)
- Notch benefit differences are "significant." (NASI, p. 1)
- The Notch affects not only those born between 1917 and 1921, but it also affects those born afterwards. The study panel says that benefit differences for persons born after 1921 are "quite comparable ..." (NASI, p. 8) The National Committee supports legislation that would provide benefits for Notch victims born between 1917 and 1928.

One other area of apparent agreement is that Congress intended a gradual transition. The study panel apparently concedes that no documentation exists which contradicts our research.

The heart of our disagreement with the study panel is its claim that 1) the Notch is due primarily to "windfall" benefits paid to "bonanza babies" and 2) "adequate financing of the whole program would be adversely affected (p. 21)" if trust fund monies are used to correct the Notch. The study panel, however, uses misleading information to support its first claim about benefits and failed to provide any evidence in support of its second claim about financing.

Benefits

The study panel claims that "the notch situation could have been reduced – and, in many cases, eliminated altogether – if, in 1977, Congress had adopted a provision that placed a cap on the windfall being received by workers born before 1917 who worked in 1979 and after." (NASI, p. 16) Notwithstanding the fact that Congress decided not to do this, the question remains – does the study panel prove its point? Not hardly. The study panel invented a fomula for eliminating the windfall. Using this invented formula, the study panel developed a table that compared benefits of those born in 1916 and 1917. It did not compare benefits of those born either before 1916 or after 1917! On the basis of this invented formula and the table, the study panel concludes that "the differences between the benefits of those born in 1916 as compared to those born in 1917 are, on the whole, only about one-fifth as large for the alternative procedure as under present law." (NASI, p. 17)

If you compare benefits of those born in 1916 and 1920, however, you would still see a substantial Notch of 15 percent which would be worth more than $1,050 a year ($87.60 a month) to the "average" male earner who retired at age 65! The following table was adapted from Table 1 of the National Academy's report to reflect the "elimination of the windfall."

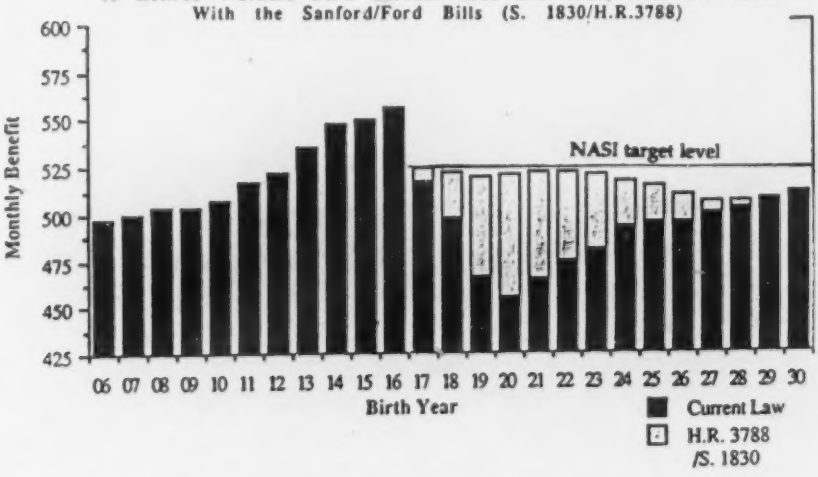
TABLE
Illustrative Monthly Benefits for Men who Retired at Age 65 with Average Creditable Earnings in All Previous Years Using Invented Benefit Formula to Eliminate Windfall in 1916 and Current Law for 1917-22

Year of Birth	Monthly Benefits Eliminating Windfall	Monthly Benefit Difference from 1916	Percentage Difference from 1916
1916	$684.30	–	–
1917	$670.10	$14.20	2%
1918	$644.40	$39.90	6%
1919	$611.20	$73.10	11%
1920	$596.70	$87.60	15%
1921	$608.30	$76.00	11%
1922	$618.40	$65.90	10%

Source: National Academy of Social Insurance, "The Social Security Benefit Notch: A Study," November, 1988, p. 7. The adjusted benefit for 1916 was derived by taking one-fifth of the difference between the current law benefit for 1916 ($741.40) and the current law benefit for 1917 ($670.10), which is $14.20. This was then added to $670.10.

Whether by coincidence or not, the Sanford compromise would increase benefits up to but not over the "windfall" level as identified by the National Academy of Social Insurance. This can be seen by looking at the chart comparing average monthly benefits for workers born between 1906 and 1930 under current law and the Sanford compromise. If the study panel had fully developed its benefit analysis and analyzed various options, wouldn't they have chosen the Sanford compromise as the best solution?

Comparison of Actual and Projected Average Monthly Benefits Paid to Retired Workers Born Between 1906 and 1930, December 1986 With the Sanford/Ford Bills (S. 1830/H.R.3788)



Source: SSA for current law December 1986 benefits 1906-1930, National Committee re-estimates of SSA data for current law 1920-21; National Committee staff re-estimates for current law 1922-30. Line drawn at NASI target level.

The Sanford compromise incorporated a provision to reduce the "windfall" to persons born before 1917 who continue to work. This provision would save $4 billion over 10 years. Surprisingly, the study panel did not recommend doing even this as a way of minimizing the inequity.

In addition, the National Committee has uncovered numerous examples of two beneficiaries, one born before the Notch and one born during the Notch, with nearly identical work histories who have benefit differences even larger than shown for the so-called "average" earner. Most real workers earn below the average when young and above the average when old. For this worker, the 1972 benefit formula was much more advantageous than it was for the "average" earner. And the 1977 benefit formula was more detrimental to the worker who had above average earnings when old. These two factors magnified the notches for many beneficiaries.

Another issue that we hope everyone can agree on is that replacement rates do not explain benefit changes to beneficiaries. Beneficiaries make comparisons by looking solely at benefit amounts. Replacement rates are a valuable tool only for long-term policy analysis. The study panel was really reaching for straws when it suggested that a notch correction would "create a new notch in benefits when considered relative to earnings (i.e., in replacement rates...)" (NASI, p. 18)

Replacement rates can be very misleading because they depend on "what" is being replaced. In 1977, for example, Senator Tower proposed an alternative benefit formula which would have resulted in declining replacement rates rather than the stable replacement rates proposed by the Committee and supported by the National Committee. But even Senator Tower was not talking about <u>any</u> reduction in benefits. He boasted that "in terms of 1977 prices that the benefits would almost double from the year 1979 to the year 2050." (Congressional Record, November 4, 1977, p. 37187)

Attached to our statement is more explanation of the limitations in replacement rate analysis.

Financing

If adequate financing of the whole program would be adversely affected by a correction of the Notch, the National Committee would support additional financing. But it is not necessary to have additional financing, because a Notch compromise such as the one proposed by Senator Sanford would not undermine either the short-term or long-term solvency of the Social Security system. But the National Academy did not look at the financing of Social Security.

Six years ago, there was justifiable alarm about Social Security's short-term solvency. With your help, Mr. Chairman, the Social Security Amendments of 1983 saved Social Security. All Americans are grateful. If the projected trust fund reserve ratios were considered adequate at that time, then the Sanford Notch compromise would not jeopardize Social Security's short-term financing. This is because Social Security has done even better than projected in 1983. If the Sanford compromise was passed, the trust fund reserve ratios would still be higher than they were projected to be in 1983, as illustrated by this table.

TABLE
COMPARISON OF TRUST FUND RESERVE RATIOS

YEAR	PROJECTED AFTER 1983 AMENDMENTS	CURRENT LAW AFTER SANFORD COMPROMISE
1988	24	35
1989	29	46
1990	38	57
1991	51	70
1992	64	84
1993	80	98
1994	98	113
1995	117	128
1996	137	143
2000	221	234

Note: Trust Fund reserve ratio represents trust fund assets at the beginning of the year (including advance tax transfers representing January Social Security benefits) as a percentage of expenditures during the year.

Sources: 1983 Trustees Report; Communication from the Office of the Actuary, Social Security Administratrion, to Rep. Harold Ford, April, 1988.

The long-term impact on the trust funds is almost negligible. Based on the 1988 Trustees Report and a long-term cost of 0.07 percent of payroll (see GAO report, p. 69), the Trust Funds would still be in "close actuarial balance" after passage of a compromise similar to the Sanford bill. In fact the long-term cost is less than one-half of one percent of the long-term cost of Social Security. The long-term cost is so low because the group of Notch victims is finite; they will eventually die.

HIDDEN AGENDAS

Could it be the most important obstacle to solving the Notch lies in "hidden agendas?" While Social Security financing is sound, it is no secret that Congress is using annual Social Security surpluses to hide the budget deficit. Correcting the Notch without any additional financing would expose this accounting trick. Mr. Chairman, we know that you oppose this accounting trick as strongly as we do.

But while you want to balance the budget independent of the Social Security surpluses, you prefer to accumulate a large reserve fund to partially "prefund" the benefits of the baby boom generation. The study panel sidestepped this We recognize the good intentions involved in trying to accumulate a reserve, but we believe that it is both unwise and unnecessary.

It is unwise because it plays into the hands of those who want to continue to use the surplus to hide the budget deficit. As a student of politics, you must agree that it is unlikely that Congress would let such a pot of money accumulate without dipping into it. This is one area with which we agree with Robert Myers, who chaired the National Academy study panel.

It is also unnecessary to maintain such high payroll tax rates on today's workers to both pay the benefits of their parents and prefund their own benefits. In fact, over the years, Congress has eliminated or postponed scheduled payroll tax rate increases to partially prefund Social Security, preferring instead "current cost financing." As Mr. Myers has demonstrated in the Fall, 1987, issue of the Mercer-Meidinger-Hansen Social Security newsletter, the Social Security payroll tax rate will eventually have to be increased -- the question is not if but when -- and that such an increase would not be a "crushing" blow on future workers under current cost financing.

It is probably even more indefensible to maintain the current level of taxation on today's workers once a 100% reserve is achieved. As Alicia Munnell, president of the National Academy of Social Insurance, has written, the baby boom generation "attended overcrowded schools, experienced difficulties finding jobs, and found slow advancement on the job. The mere size of this group has contributed to the virtual freezing of real wage growth for a decade and has made it difficult to find affordable housing. Whether or not this group should be the one to contribute towards its own retirement in addition to financing benefits for current retirees is an issue that should be part of the debate." (Perspectives, NASI Newsletter, September, 1988)

CONCLUSION

On behalf of our five million members and supporters, I urge you to adopt a Notch correction to put an end to the disparity in benefits which has so troubled beneficiaries for nearly twelve years.

APPENDIX A

CONGRESSIONAL INTENT
SOCIAL SECURITY AMENDMENTS OF 1977

POST-ENACTMENT DESCRIPTION OF PUBLIC LAW 95-216.

"The benefit level adopted for the long-term is 5 percent below estimated 1979 levels. Included in the legislation is a 5-year guarantee of December 1978 levels to provide a gradual transition to the new system for workers who will reach age 62 in 1979 through 1983." *The Social Security Amendments of 1977, Public Law 216, 95th Congress, Brief Summary of Major Provisions and Detailed Comparison With Prior Law*, U. S. House of Representatives, 95th Congress, 2d Session, Ways and Means Committee Print 95-72, (p. 3), April 3, 1978.

CONFERENCE REPORT FOR FINAL PASSAGE, H.R. 9346, DECEMBER 15, 1977

"The House bill provided for a benefit formula producing benefit amounts roughly 5 percent lower than estimated present-law benefits at implementation (January 1, 1979).

"The Senate amendment benefit formula produced benefit amounts roughly equivalent to 1976 levels -- about 2-1/2 percent lower than estimated present-law benefits implementation.

"The Senate recedes." Joint Explanatory Statement of the Committee of Conference, House of Representatives Report 95-837, 95th Congress, 1st Session, p. 67)

SENATE CONSIDERATION, NOVEMBER 1-4, 1977

***"Revised benefit formula for future retirees.* - The formula adopted is designed to maintain benefit levels as a percent of preretirement income at approximately the same ratio as applied in the case of persons who retired in 1976."** (Excerpt from Finance Committee Press Release on Senate Amendments to the Social Security Act, Submitted for the record by Finance Committee Chairman Russell B. Long. *Congressional Record*,, p. 36477, Nov. 2, 1977)

"Social security replacement rates would be set at their 1976 levels, an amount calculated to be about 43 percent of an average worker's earnings the year before retirement. These replacement rates would be held constant thereafter. . .
would provide that future benefits be based on 'indexed' earnings rather than the actual earnings under the present law. . .

"A basic change such as that which would be provided by the committee bill also requires many substantial changes in provisions of present law. transitional provisions for the period during which the new system is implemented, and a number of conforming amendments to minimize possible disruptions that so basic a change in the benefit structure might otherwise produce. . .

"We felt that American workers would be willing to pay additional tax dollars if they could be assured that their parents and grandparents would continue to receive their monthly benefit checks and if they could be assured that the benefits to which they are entitled would not be diminished in the future. (Explanation of Senate Bill by Senate Social Security Subcommittee Chairman Gaylord Nelson,*Congressional Record*, pps. 36480-36482 Nov. 2, 1977).

"I will just give a few illustrative figures so that everybody will be familiar with what they are voting on.

"Under the Finance Committee bill, the average worker would receive a replacement rate in retirement 43 percent of his earnings the year before retirement. That is to say, the average replacement rate would be stabilized at 43 percent from now on. It is at 46 percent in 1977. . .

"Under the proposal in the amendment offered by the Senator from Texas, the replacement rate would go from 46 percent in 1979 - which it is for all other proposals - to 41 percent in 1985; in 1990 to 38 percent; in 1995, to 36 percent. . .

"The replacement rate under the Tower amendment would (in 2050) be 26 percent, whereas the replacement rate under the Finance Committee proposal would remain at 43 percent for those earning the average income." (Remarks of Senator Nelson, explanation of differences between Committee bill and Tower amendment which was tabled, 48 to 21, Roll Call vote 630, Nov. 4, 1977, pp. 37186-87.)

SENATE REPORT, NOVEMBER 1, 1977

"Under the benefit procedures included in the committee bill, the relationship between the benefits paid at the time of retirement and earnings in the year prior to retirement is expected to be a constant 43 percent for a person retiring at age 65 with earnings in all years equal to the national average. . ." (Senate Report 95-572, 95th Congress, 1st Session, *Report of the Committee on Finance, U. S. Senate on H.R. 5322* (i.e. as amended to substitute Senate Finance Committee recommendations for amendments to the Social Security Act p. 19)

HOUSE CONSIDERATION, OCTOBER 26, 1977

"H.R. 9346 includes important 'decoupling' provisions to correct the unintended effects of the benefit formula adopted in 1972. The provisions are designed to stabilize future benefit replacement rates on a permanent basis at about 5 percent less than those that will be paid in 1979." (House of Representatives, Debate on H.R. 9346, *Congressional Record*, Ways and Means Chairman Al Ullman, p. H 11531)

"The bill would prevent the unintended rise in future replacement rates (and costs), and assure that future replacement rates would remain fairly constant at a level approximately 5 percent lower than the level that will prevail in January 1979." (Description of H.R. 9346, *Congressional Record* , p. H 11533)

"Mr. Chairman, I want to mention some good features of the bill. . .First of all, the decoupling and wage indexing provisions. . .We must decouple and stabilize replacement rates. This bill stabilizes them at a level about 5 percent lower than those existing in January 1979. I think that is a sound proposal, and I am glad it is in

there." (Ways and Means Committee Ranking Minority Member, Barber Conable, *Congressional Record*, H 11539)

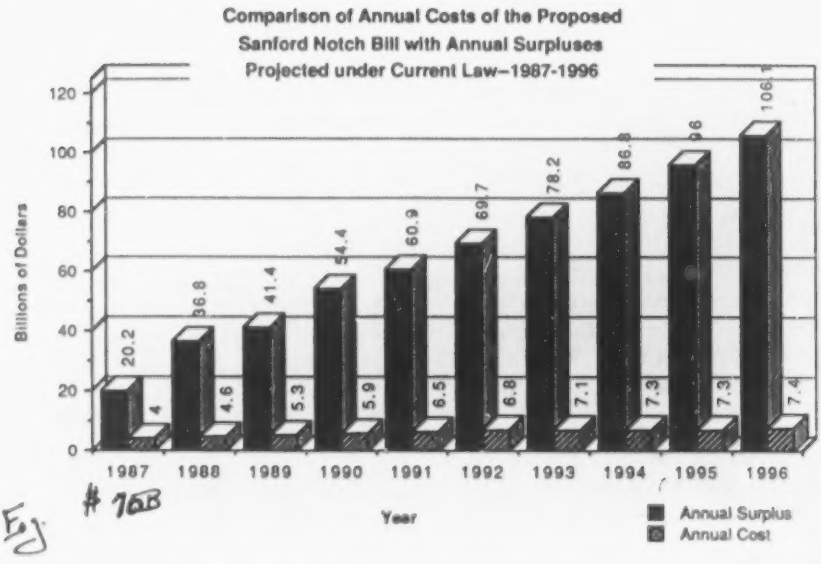
"This bill fixes and stabilizes the replacement rate at an average of 43 percent for all times in the future. If this bill did nothing more than this it would be a huge success." (Mr. Gephardt, p. H 11559)

HOUSE REPORT, OCTOBER 12, 1977

"Your committee recommends that replacement rates be stabilized at a level 5 percent lower than the levels that will prevail in January 1979. . ." (*Report of the Committee on Ways and Means, House of Representatives, To Accompany H.R. 9346*. House Report No. 702, Part 1, 95th Congress, 1st Session, p. 23)

Replacement Rates: Historical Behavior and Projections Under Present Law and Under the Committee Bill. (House Report, p. 24)

"The formula is designed to produce benefit amounts which are on the average about 5 percent lower than the benefits which would be payable under present law to workers who retire in January 1979, when the revised benefit structure would go into effect." (House Report, p. 27)



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- For the first five years, the average annual cost of the Sanford proposal is $5.2 billion, while annual surpluses average $42.7 billion.
- After five years, the average annual cost of the Sanford proposal stabilizes at about $7.3 billion while current law's annual surpluses are projected to increase by about 40 percent -- from $76.1 billion in 1992 to $106.1 billion in 1996.
- Over ten years, the total cost of the proposed Sanford bill, including partial retroactive payments, equals only 10.4 percent of the $650 billion projected increase in the Social Security Trust Funds.

Note: Chart does not reflect $5.4 billion in costs for retroactive benefits of up to $1,000 per retired worker for 1979-1986.

SOURCE: Social Security Administration data arranged in table prepared by the National Committe to Preserve Social Security and Medicare, Washington, D.C. 20006, (202) 822-9459; 10/21/87

THE HONORABLE BRUCE W. SUMNER, MEMBER. BOARD OF DIRECTORS
NATIONAL COMMITTEE TO PRESERVE SOCIAL SECURITY AND MEDICARE

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Balanced analyses of current proposals before the Congress, prepared with the help of specialists in law, economics, and government.

Proposals to Deal with the Social Security Notch Problem

1985
99th Congress
1st Session

American Enterprise Institute
for Public Policy Research
Washington, D.C.

1

INTRODUCTION

Members of Congress regularly confront a multitude of social security problems. In recent years, however, none has plagued them more in town meetings and constituent mail than the social security notch problem.

Arising out of major benefit reform and financing legislation enacted in 1977, the benefit notch—a perceived loss of benefits by recipients who first became eligible after 1978—has created an image problem, one that raises concern about congressional ability to legislate fair changes in the social security program.

Although the notch was unintended, the changes in the benefit rules enacted in 1977 were urgently needed. The benefits awarded to new social security recipients were rising rapidly—at rates exceeding both inflation and wage growth in the economy. Without action by Congress, the rising benefits and a deteriorating economy would have made the system financially insolvent within a few years.

Resolution of the current issue is not a simple matter. Repeal of the benefit changes enacted in 1977, as is suggested in a number of the bills that have been introduced in the current and past two Congresses, would carry enormous costs and resurrect the major policy issues that led to the legislation in the first place. Even legislation intended merely to ameliorate the notch, by allowing retirees becoming newly eligible during the current and following decades to make greater use of the old rules, carries costs approaching $100 billion during the next six or seven years alone, possibly threatening the modestly secure financial condition of the system and also exerting enormous adverse pressure on the already troublesome federal budgetary situation.[1]

Nonetheless, more than 7 million workers born after 1916 have filed for retirement benefits during the past six years.[2] Some suffered no loss from using the new rules, and others came out ahead, but many have complained vigorously about the notch and have consequently imposed considerable pressure on their elected representatives to redress the inequity. Lack of action can be perceived as lack of interest or ineffectiveness, while support of proposed legislation that threatens the financial condition of the system and might add tens of billions of dollars to already bloated

federal budget deficits smacks of fiscal irresponsibility of a high order. Thus, for many members of Congress, the situation poses a complex political problem.

This legislative analysis describes what the notch problem is and how it arose, emphasizing the reasons for and the nature of the legislation that caused it. It elaborates on the dimensions and character of the inequity, illustrating a number of ways in which it can be viewed. Finally, it discusses a number of bills pending before Congress to deal with the problem and provides arguments for and against enactment of such measures.

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BACKGROUND

> I would like to make it clear that no individual has his or her benefit raised or lowered by the notch. It is a matter of a difference in benefits between two individuals who by accident of birth fall on different sides of an arbitrary date set in the 1977 amendments.[3]

FRAMING THE ISSUE

At first glance the notch is a seemingly blatant example of inequity, rarely seen in social security amendments, in which people with very similar work histories wind up with very different benefits simply because they were born a year or two, a few months, or even as little as a few days apart. How big a difference? In one extreme case recently cited by Representative Edward R. Roybal (D-Calif.), a sixty-seven-year-old Iowa woman would, if she retired on her own record today, receive benefits that are 31 percent lower because she happened to be born on February 12, 1917, rather than on December 31, 1916. That six-week difference in her birth allegedly means that she would receive $160 a month less in benefits for the rest of her life.[4]

How could Congress enact legislation that produced such a large difference based merely on whether someone was born before 1917 or after 1916? Birth dates are not a measure of contributions to the social security system, nor do they imply social merit. "Why," asks the recipient receiving the lower benefits, "should John Smith down the street get $100 more a month than I for life because he is a little older? I worked next to him in the plant for years. We had the same jobs, earned the same wages, and paid the same amount of social security taxes. Tell me how this is fair."

In a sense the notch problem adds a new layer to a broader, more pervasive issue. Where doubts and uncertainty pervade opinion poll findings of how younger workers feel about the future of the social security system, the notch issue has introduced an element of disenchantment among an older, seemingly more trusting generation, relatively confident that the government would not capriciously alter its social security commitments to them and certainly not in an abrupt manner that leaves one

group of people less well off than another.[5]

It is also no coincidence that veterans' groups have picked up the issue. Many of those who perceive themselves as being unjustly penalized —having been told they are because they were born from 1917 to 1921, the so-called notch years[6]—are World War II veterans who wonder why they, of any group, are being asked to take lower benefits from their government.[7]

What kind of law creates this situation?

The fact is that no one wanted the notch to occur. Nor was it an anticipated but unfortunate consequence of needed legislation. It was an unanticipated side effect of badly needed legislation. It arose out of a complicated set of changes in the way social security benefits were to be computed in the future—changes needed because without them the system would have become grossly unaffordable as a consequence of paying greatly elevated (and, by most accounts, excessive) benefits to future recipients.

Social security benefits had been determined through a single table of benefits in the law that matched different average career earnings with different benefit amounts. Amendments enacted in 1972 and 1973 made benefit increases payable automatically as the cost of living rose; every time a benefit increase was given, every benefit amount in the table was raised. Because all social security benefits were determined from this single table of benefits, the benefit increases given to existing recipients were also built into the benefits that future recipients would receive, even though their benefits would have reflected inflation in any event through the rising wages they received during the intervening years. In effect, by building current benefit increases into the eventual benefits of people still in their working years, the 1972–1973 amendments created a sort of double adjustment for inflation for future recipients.

If the 1977 changes had not been made, many people retiring after the turn of the century would have received benefits well in excess of their preretirement earnings. And paying benefits that would be higher than a recipient's earnings from work was a clearly untenable policy.[8]

Thus the benefit changes enacted in 1977 were not directed just to people born from 1917 to 1921 but to everyone born after 1916. Those born from 1917 to 1921 were made eligible for certain special benefit rules that in some instances actually made them better off than those born after 1921 as well as those born before 1913. When the current benefit levels for successive groups of new retirees of the past ten years are observed, it quickly becomes apparent that the term "notch" is a misnomer. There is no question that the benefits currently paid to people who reached age sixty-two (the first age of eligibility for retirement benefits) in 1979 are in many cases notably lower than they would be if these people had become

eligible the previous year, but generally they are not lower than the current benefits being paid to people who first became eligible in 1974 or earlier.

In reality the notch recipients who perceive unfair treatment are comparing themselves with earlier recipients who may have received too much from the system. The groups of new recipients who immediately preceded those in the notch years may have reaped windfalls by being permitted to use the old benefit rules without limitation. Those benefit rules were faulty—few experts disputed this fact in 1977.[9] But Congress permitted people who had just become eligible and those who would become eligible in 1978 to continue to use them so that their retirement incomes would not be changed abruptly or their retirement plans disrupted.[10]

That generosity set the stage for the notch issue. Whether the notch recipients are being unjustly penalized or earlier retirees are receiving windfalls does not matter much to those now receiving lower benefits—to them the difference is clearly unacceptable, especially from a system in which they perceive their benefits to have been earned as a matter of right through years of contributions.

What Is the Notch?

A common misperception of the notch is that an individual could have avoided it if he or she had been eligible for social security before 1979 and had chosen to file for benefits then. The fact is that the choice of a particular retirement or filing date has nothing to do with it.

The notch is a benefit difference that results from a person's being born before or after a particular date. People who reached age sixty-two before 1979—that is, who were born before 1917—have their social security retirement benefits computed under rules that were generally effective before enactment of the Social Security Amendments of 1977. Whether they chose to file in 1977 or decided to wait until 1987, the old rules apply to them. People who reach age sixty-two in 1979 or later—that is, who were born after 1916—have their benefits computed under rules prescribed by the 1977 amendments.

The fact that different benefit rules apply to people of different ages is not itself an issue. And the fact that different amounts of benefits are paid to different generations of recipients is not an unusual outcome of amendments to the social security program. It would probably be hard to find a set of social security amendments among the fifteen or more enacted since 1935 that did not include at least some provisions having the result of treating certain age groups differently.[11] It would also be hard, however, to find a previous change in the benefit rules that created such a large and readily visible difference in benefits for such a large number of people so close to one another in age.

The 1977 benefit computation changes were deliberately designed to produce lower benefits than the old law. According to the 1977 reports to the House of Representatives from the Committee on Ways and Means and to the Senate from the Committee on Finance, the creation of new benefit computation rules that would produce benefits below those that would have arisen under the old law was a major ingredient in restoring the long-range financial well-being of the social security system.[12] Both committees approached the issue with similar provisions, which established 1979 as a pivotal year. The bills they drafted were designed to produce long-range benefit levels that would be lower, relatively speaking, than those projected to arise under old law for people becoming newly eligible for benefits in January 1979. The House bill set them approximately 5 percent lower, the Senate bill approximately 2.5 percent lower. In conference the House-passed levels were agreed to and subsequently became the law.[13]

What does "relatively speaking" mean? Was Congress really trying to establish future benefit levels below those that would exist in 1979? Wouldn't this mean that future retirees would be far behind as inflation eroded the value of the dollar?

Actually, the committees were not pegging future benefits to lower dollar amounts than would be payable in 1979. They were attempting to establish a stable long-run relation between a recipient's benefits and his or her preretirement earnings.[14] The idea was that the value of benefits in relation to earnings at the time of retirement should not change from one generation of retirees to another.

Experts in the retirement and pension field refer to this relation as a replacement ratio or replacement rate. It is the percentage of recipients' earnings from work that are replaced by the retirement benefits they receive.

The new benefit computation rules adopted in 1977 were intended to produce long-range replacement rates for the social security system that would not change over time. Congress agreed to a set of procedures that when fully implemented would result in replacement rates about 5 percent lower than those expected for workers retiring at age sixty-two in 1979.[15] As wage levels rose, benefits would also go up, but the relation of the initial benefits of future retirees to the earnings they had received just before retiring would always be the same.

The replacement rate for a worker retiring at age sixty-two in 1979 who earned average wages steadily during his working years was projected to be 44 percent (ignoring reductions made because of retirement before age sixty-five). The 1977 report to the House by the Ways and Means Committee showed that similarly situated workers retiring at age sixty-two in later years could always expect to receive a replacement rate of 43

percent (once again, ignoring the early retirement reduction) and stated that the committee had deliberately established this lower rate because it felt that the growth in replacement rates that had occurred in the five-year period since 1972 was unintended.[16]

There was thus nothing accidental about the fact that the benefit rules prescribed by the 1977 amendments would produce, on the average, lower benefits for future recipients than the old rules. What was unplanned was the sudden effect of the new rules. The transition measures incorporated into the 1977 amendments did not produce a smooth transition to the new rules in the dollar amounts of initial benefits that would be paid to successive groups of new retirees in the first few years after enactment.

The idea of applying the new rules on the basis of whether or not someone had become eligible—reached age sixty-two—by the effective date of the change in the rules was not wholly arbitrary. It was done so that a worker's decision to choose a particular date to retire or file for benefits would not be influenced by whether he or she would be subject to a different set of benefit computation rules. The intent was to avoid having the change in the rules cause either a rush to apply for benefits before the effective date of the change or a delay on the part of those who would be advantaged by the new rules. It also avoided the inequities that might result if some people could choose an optimum point to file because they were aware of the change in the law while others could not because they were unaware of the change.[17]

Although there appears to be no explicit statement in the legislative history, Congress probably anticipated that even though it was cutting benefits for new recipients from what they would have been under the old law, the actual dollar amounts of benefits they would receive would be slightly higher than those of the groups retiring before them.[18] Ordinarily it would have been reasonable to expect the benefits of each successive group of retirees to be slightly higher simply because wages tend to rise over time and those higher wages ultimately result in higher social security benefits. Moreover, the goal of the new benefit rules was only to remove an overadjustment for inflation, and there were grandfathering and transitional provisions built into the new law for those in or approaching retirement. What appears to have been unforeseen, for lack of analysis showing year-to-year benefits under the pending legislation, was that many people becoming newly eligible in the first few years after the new rules became effective would actually get a lower dollar amount of benefits than people who became eligible in the few years just preceding the effective date.[19]

These lower benefits have nothing to do with how much an individual worked during his lifetime in jobs covered by the social security system. They have nothing to do with how much the individual paid in social

security taxes during his working years. Nor can it be said that they evolved from a desire to achieve a particular social welfare objective. Thus, although the decision to apply the new rules to people of a given age and younger was not completely arbitrary, the resulting benefit differences were.

The Old Rules and the New Rules

In what way did the new rules produce lower benefits than the old rules? Actually, not everyone who used the rules prescribed by the 1977 amendments received lower benefits. Some people got higher benefits. They are not the norm. They illustrate, however, that although the transition provisions may not have worked well, their effects were not uniformly unfavorable to people born from 1917 to 1921.

As the transition to the new system was designed, the retirement benefits of anyone born from 1917 to 1921—that is, anyone who reached age sixty-two from 1979 to 1983—were computed under both the new rules and a set of modified old rules referred to as the transitional guarantee. The Social Security Administration was to use whichever method produced the higher amount to determine what these first few groups of newly affected retirees were to receive.

According to an analysis done in 1981 by the Office of the Actuary of the Social Security Administration, many people who became newly eligible and entitled to benefits in the first three years after the new law became effective received higher benefits by using the new rules than if they had used the transitional guarantee method. Although a number of alternative new methods were created by the 1977 amendments, the basic one—the so-called indexing method—was advantageous for 44 percent of the men and 34 percent of the women who became eligible and filed for retirement benefits in 1979.[20] The benefits of these initial users of the new rules—largely people who retired at age sixty-two—were not always higher than the unencumbered old rules would have produced, but it is likely that a very large proportion of them were. Those recipients have not complained about any "upwards notch," for obvious reasons. The point is that not everyone whose birth date falls into the so-called notch years was unjustly penalized by a sudden change in the rules.

The transition to the new system did not work well, because some people received substantially lower benefits than they would have received if they had been able to use the old rules. It was recognized in 1977 that initially some people would get more from the new rules and some would be largely unaffected, but that people would get markedly lower benefits was not expected. The transitional guarantee was supposed to guard against such sharp reductions, at least in principle.

Would it be correct, then, to surmise that the notch is the consequence of the transitional guarantee's failing to operate properly? That provides only a partial explanation. Failure can also be attributed to the fact that the limitations built into the transitional guarantee on how the old rules could be used were not applied to earlier groups of social security retirees, those who were born before 1917. Although the transitional guarantee was supposed to minimize the reductions from benefits under the old law for persons born from 1917 to 1921, the limitations required with its use did not apply to people born in 1916 or earlier and therefore did not guard against excessive benefit growth for those recipients.

In effect, the transition to the new system comprised two stages, not one. No limitation (on the use of the old rules) would apply to anyone who had already reached aged sixty-two by 1977 or would reach age sixty-two the following year, regardless of when those people joined the retirement rolls. Special but less generous rules (the transitional guarantee) would be available to people who were fifty-six to sixty years old in 1977, if the new rules would affect them too adversely. And people then age fifty-five or younger would have to use the new rules without exception.

In a sense people born in the so-called notch years had advantages that younger workers were not given. Had they not been able to use the transitional guarantee, their benefits—derived under the new rules—would have been considerably smaller than they were, and the prevalence and magnitude of the perceived benefit notches would have been even greater.

How did the transitional guarantee work? It was essentially the old method of computing benefits with two limitations. One was that earnings occurring in the year a worker reached age sixty-two or later could not be used in determining benefits. Such earnings could have been used under the old law, and if using them raised a person's average earnings, higher benefits would have resulted. Under the new law new retirees could count these earnings if they had their benefits computed under the new rules but not if they used the transitional guarantee. They were, however, permitted to use the transitional guarantee at first without these earnings and subsequently switch to the new rules if their earnings after age sixty-one later made the new rules beneficial. The intent was to make it advantageous for people who continued to work past age sixty-one to use the new method and thus to shift as many people as possible into the new system quickly.[21]

The second limitation was that benefit increases occurring before the year a worker reached age sixty-two would not be factored into his or her initial benefits. What this meant was that a worker's benefits would first be determined from the benefit table in effect in 1978. If the worker did not reach sixty-two until 1982, benefit increases given during the 1979–1981 period would not be built into his or her initial benefits, as they would have

been under the old rules. This was one of the essential components of the new rules as well. In fact, it was the major feature of the new rules that removed double indexing from social security benefit computations.

Given these limitations, what was it about the new rules that still made the transitional guarantee advantageous for some people? It was the indexing of a person's earnings history. Under the new rules, earnings of every year in a worker's earnings record after 1950 and until the year a worker reaches age sixty would be raised or indexed by the growth in the national average wage. This was done not so much to deal with the problem of double indexing as to remove distortions or inequities in benefits caused by the general rise in wage levels over a person's working years. Since national wage levels tend to rise over time, earnings that occur early in one's lifetime appear to be very small when one looks back at them at the time of retirement. If a person had worked at the same job a few years before retiring, those wages would have been much higher because of inflation and productivity increases that occurred over the years even though the real value of the wages had not changed much. Wage indexing of earnings histories was adopted as a means of lessening this distortion.[22]

This change by itself obviously would have pushed everyone higher up into the benefit table. The new rules abandoned the benefit table, however, substituting instead a benefit formula. Once a person's average indexed earnings were determined, a three-step benefit formula would be applied to them. The social security actuaries developed this formula so that, when coupled with the indexing of earnings histories, the resulting initial cost of newly awarded benefits (that is, in 1979) would be slightly lower, on the average, than it would have been under the old rules.

In effect, these new rules, which indexed earnings histories yet left average new benefits about where they otherwise would have been, redistributed the social security pie. Average benefits would be the same, but some people would get more and others less, depending on how the wage indexing of earnings histories affected them. People who reached their earnings potential early in life would have an advantage, and those who reached it late in life would be at a disadvantage. The differences from old law benefit levels could be very large in some cases.

The availability of the transitional guarantee to people who reached age sixty-two shortly after the new rules were made effective (in the 1979–1983 period) was intended to mitigate the differences where they would have resulted in large benefit losses.

The transitional guarantee did make a notable difference for many recipients, particularly in the first year or two after the new law became effective, that is, for persons reaching age sixty-two in 1979 and 1980. The previously mentioned actuarial analysis, for instance, showed that an average steady earner retiring at age sixty-two in 1979 received $383.10 a

month in January 1979 under the transitional guarantee method rather than the $365.90 a month he would have received under the new indexing method. A retiree who had always earned maximum wages for social security tax purposes got $486.10 a month under the transitional guarantee rather than the $454.10 he would have received if the wage indexing method had been used.[23] Furthermore, these were not the kinds of cases where the transitional guarantee provided its largest advantage. The actuarial analysis was based on work histories that assumed steady earnings growth throughout a person's working years, but the transitional guarantee was most effective for people whose earnings spurted late in life. The extreme cases would be those in which people had no earnings in the first half of their potential working years or initially had earnings that grew more slowly than the national average but in later years had earnings that grew more quickly than the national average. These were the cases where the new rules would have caused the greatest reductions from old law levels.

Although the transitional guarantee cut the losses that many would have faced under the new rules, it still produced substantial reductions from what would have resulted under the old rules. Typically, these differences were greatest (1) for people who continued to work for a number of years after reaching age sixty-two, because their earnings after age sixty-one could not be factored into their benefit computations; and (2) for people who had to forgo one or more of the large benefit increases of the 1979–1981 period because they reached age sixty-two after the increases were put into effect.[24]

It is sometimes suggested that the notch would not have arisen if the future assumptions about inflation around which the 1977 benefit changes were planned had materialized. Since inflation was much worse in the following four or five years than was expected, it is perceived that the benefits of those still under the old system were greatly elevated by the automatic benefit increases provided in the 1979–1981 period and that the omission of these large increases from the benefits of those required to use the new rules caused or greatly exacerbated the notch. It is true that the dollar differences between the benefits determined under the old and the new rules were somewhat larger because inflation was more acute. Even if the inflation assumptions made in 1977 had turned out to be accurate, however, the notch would have existed, and in percentage terms the benefit differences it created would not have been much smaller than those that arose. The fact is that the notch arose directly from the provisions enacted in 1977, not from the unexpected economic conditions that followed.

3

Proposed Legislation and Other Measures

Four directions could be taken in response to the notch problem. One is to do nothing—to ride out the storm. The people perceiving themselves as having been adversely affected are a closed group of recipients. The new benefit computation rules do not appear to carry the same pitfalls as the transitional provisions, and large benefit differences between successive groups of new retirees in the future are not likely to arise again. The notch could be viewed as an unfortunate, one-time problem with the system.

Many of the people who perceive themselves as having been unjustly penalized, however, can be expected to receive benefits for another fifteen, twenty, or more years into the future, and the notch would be a permanent part of their benefits. If Congress believes that it must respond to the problem, three forms of legislation are possible. One would be to equalize up—that is, to raise benefits for those who feel aggrieved. A second would be to equalize down—that is, to reduce the benefits of those who may have received windfalls. The third would be to refund a portion of the social security taxes of those who feel that their benefit rights have been abrogated.

Bills Introduced in Congress

Twenty-one bills and resolutions addressing the notch problem were introduced in the 98th Congress, sponsored by more than 150 members of the House and Senate. In the first six months of the 99th Congress, ten bills and five resolutions were introduced to deal with the issue (table 1). Nine of the bills would directly alter the way benefit computations are made. All of them are of the equalizing-up variety. Four of the five resolutions and one bill would require the administration to study the problem and make recommendations to solve or mitigate it. One resolution would call upon Congress to make a specific expression about its perspective on the matter.

Although concern in Congress about the notch is widespread and bipartisan, no action was taken on any of the bills introduced in the 98th Congress, and at the end of June 1985 no action had been taken in either

TABLE 1
NOTCH BILLS INTRODUCED IN CONGRESS, 1985

Number of Bill or Resolution	*Sponsor*	*Date Introduced*
	Bills that raise benefits for notch recipients	
H.R. 65	Rep. Michael Bilirakis (R-Fla.)	January 3
H.R. 401	Rep. James H. Quillen (R-Tenn.)	January 3
H.R. 732	Rep. George C. Wortley (R-N.Y.)	January 24
H.R. 920	Rep. Barney Frank (D-Mass.)	February 4
H.R. 921	Rep. Barney Frank (D-Mass.)	February 4
H.R. 1118	Rep. Don Fuqua (D-Fla.)	February 19
H.R. 1744	Rep. Richard C. Shelby (D-Ala.)	March 26
H.R. 1917	Rep. Edward R. Roybal (D-Calif.)	April 2
S. 1060	Sen. Alfonse M. D'Amato (R-N.Y.)	May 2
	Bills and resolutions to study the notch	
H.R. 1916	Rep. Christopher H. Smith (R-N.J.)	April 2
H. Con. Res. 18	Rep. Joe Moakely (D-Mass.)	January 3
H. Con. Res. 41	Rep. Norman F. Lent (R-N.Y.)	January 30
H. Con. Res. 42	Rep. Marilyn Lloyd (D-Tenn.)	January 30
S. Con. Res. 24	Sen. Mack Mattingly (R-Ga.)	March 5
	Sense of Congress resolution that notch recipients should not be affected by a COLA freeze	
H. Con. Res. 96	Rep. Robert J. Mrazek (D-N.Y.)	March 21

body of the 99th Congress or in either the House Ways and Means or the Senate Finance Committee, the two committees that have primary jurisdiction over legislative matters affecting the social security program.

Proposals to Lengthen the Transition to the New System

H.R. 1917, H.R. 732, H.R. 1744, and S. 1060. Thus far, the bill receiving the greatest interest in the current Congress is H.R. 1917, introduced by Representative Edward R. Roybal (D-Calif.), chairman of the House Select Committee on Aging. It was first introduced in the 98th Congress as H.R. 4093, more than sixty members of Congress joining Representative Roybal as cosponsors. More than ninety members of the current Congress have already cosponsored H.R. 1917.

Other, virtually identical bills introduced are H.R. 732, by Represen-

tative George C. Wortley (R-N.Y.); H.R. 1744, by Representative Richard C. Shelby (D-Ala.); and S. 1060, by Senator Alfonse M. D'Amato (R-N.Y.).

These bills attempt to lessen the notch problem by lengthening the transition period to the new system indefinitely and liberalizing benefits computed under the transition rules.[25]

Under current law the transition option—under which the higher of the transitional guarantee or wage-indexed benefits are payable—ended with those who reached age sixty-two in 1983. Retirees reaching age sixty-two in 1984 and later years cannot use the transitional guarantee method. Since the transitional guarantee became less beneficial for each successive group of retirees reaching age sixty-two during the five-year transition period and since most workers retire at or before reaching age sixty-five, the transitional guarantee is now being used by only a small number of people filing for benefits.

Under the pending bills the transitional guarantee would not be phased out for fifteen to twenty years. It would not be until some time after the turn of the century that the new wage-indexing method of computing benefits would be uniformly applicable to new retirees.

The bills would extend the use of the transitional guarantee method (once again as an alternative to the wage-indexing method) to retirees reaching age sixty-two in 1984 and later. In addition, for purposes of computing transitional guarantee benefits, they would index the 1978 benefit table to reflect all benefit increases given after 1978. This, in effect, would negate the 1977 provision that precluded benefit increases from being reflected in benefits until a worker reached age sixty-two.

They would also allow a worker using the transitional guarantee to include three years of earnings received after 1978, up to $29,700 a year, in determining average wages even if the earnings occurred when a worker was age sixty-two or older.

They further include a liberalization, going even beyond the old rules, that limits to twenty-five the number of years used to compute a person's average earnings under the transitional guarantee. This, for instance, would allow a retiree with a forty-year work history to drop fifteen of his or her lowest earnings years. The provision would benefit workers reaching age sixty-two in 1982 and later, who under current law have to use an averaging period ranging from twenty-six to thirty-five years.

The bills would limit the more liberal transitional guarantee to workers who, by 1978, had already earned twenty-seven quarters of social security coverage (that is, who had at least 6¾ years of covered employment by then). It could not be used at all in computing auxiliary benefits for members of a worker's family. All the bills would make the new transition rules retroactively effective to 1979.

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H.R. 65. This bill, introduced by Representative Michael Bilirakis (R-Fla.), attempts to lessen large benefit disparities between groups of new recipients by prescribing special criteria for how the secretary of health and human services is to adjust the benefit formula each year under the new wage-indexing rules. The bill requires that, before October of each year, a projection be made of the replacement rates for hypothetical new recipients becoming entitled the following year who over their working years steadily earned minimum, average, and maximum wages (that is, maximum for social security tax purposes). The secretary is then required to prescribe a benefit formula for the following year's new eligibles that would keep the replacement rates for those hypothetical cases within five percentage points of the replacement rates of similarly situated workers who became newly entitled in 1979. The bill would apply to all present and future recipients, although no retroactive payments would be made.

H.R. 921. This bill, introduced by Representative Barney Frank (D-Mass.), attempts to lessen the benefit disparities between the old and the new law for recipients who continue to work after reaching age sixty-two. The bill would increase by 4 percent per year (⅓ percent per month) the benefits computed under the new rules for people who do not immediately file for benefits at age sixty-two, or who have them completely withheld by the social security earnings limitation. Benefits could be increased to a maximum of 12 percent, depending on the number of months between age sixty-two and sixty-five that the person did not receive them. The bill attempts to lessen the number of cases for which the present transitional guarantee would produce higher benefits than the new wage-indexing rules. The bill would apply to all present and future recipients, although no retroactive payments would be made.

Proposals to Restore the Pre-1977 Benefit Rules

H.R. 401, H.R. 920, and H.R. 1118. These bills, introduced by Representative James H. Quillen (R-Tenn.), Representative Barney Frank (D-Mass.), and Representative Don Fuqua (D-Fla.), address the problem by making the old benefit computation rules, without any limitations attached, a minimum floor or guarantee. Although the bills are not identical, they would all give recipients the higher of the benefits computed under the new rules or the unencumbered old rules. For those who became eligible in the first few years after the 1977 benefit changes became effective (1979 to 1981 or 1982), the new wage-indexing rules would still result in higher benefits in some cases than the old ones. Ultimately, however, these bills would restore the old rules for most or all future recipients, including disability recipients as well as retirees and survivors. The bills would not

provide retroactive payments but would raise the benefits of current recipients who have joined the program since 1979.

Proposals to Study the Matter

House Concurrent Resolutions 18, 41, 42; Senate Concurrent Resolution 24; and H.R. 1916. Although many members of Congress would like to resolve the notch problem immediately, the complexity of the issue has made some of them hesitant about cosponsoring one or another of the bills that directly alter the benefit computation rules or offering remedies of their own. As a consequence, four resolutions and one bill have been introduced seeking advice and direction from the commissioner of social security or the secretary of health and human services. The measures seek to draw on the technical expertise of the staff of the Social Security Administration to identify those who have been adversely affected by the change in the rules and to flesh out solutions that would lessen the benefit disparities.

The most popular of the study measures, H.R. 1916, introduced by Representative Christopher H. Smith (R-N.J.), has attracted nearly sixty cosponsors, including a number of members who have also sponsored or cosponsored some of the bills that would make immediate changes in the benefit rules. The bill directs the secretary of health and human services to conduct a study and submit a report to Congress within six months that would include a detailed analysis of the notch and its effects on recipients, an analysis of the possible effects of H.R. 1917 (Chairman Roybal's bill), and an analysis of other measures that the secretary believes would effectively deal with the problem.

House Concurrent Resolution 96. This resolution, introduced by Representative Robert J. Mrazek (D-N.Y.), would call upon the Congress to state that those affected by the benefit notch have suffered inequitable treatment under the new law. It would do so by having Congress, through enactment of a resolution, state that it is the sense of the Congress that any freeze on cost-of-living adjustments that might be imposed on social security recipients this year would not affect those born in 1917 and later who were adversely affected by the new benefit rules enacted in 1977.

Other Possible Measures

Although not reflected in bills introduced in Congress, a number of other ideas have been suggested to mitigate the notch problem.

Count earnings after age 61. Under this proposal recipients whose benefits were determined by the transitional guarantee would be permitted

to count the earnings (or portions thereof) they had in and after the year they reached age sixty-two. The 1978 benefit table would still apply to them, and, as under current law, any benefit increases that became generally effective in 1979 and later years could not be factored into their benefits until the year they reached age sixty-two. Thus people who reached aged sixty-two in 1983 and continued to work through 1984 could have their 1983 and 1984 earnings counted in figuring their benefits, as well as benefit increases that occurred in 1983 and 1984. The benefit increases that became effective in 1979 through 1982 would not be considered, however, as under the current rules.

Count certain benefit increases that would currently be excluded. Under this proposal recipients using the transitional guarantee would be able to have the benefit increases (or portions thereof) that occurred during the transition years—1979 through 1982—factored into their benefits, including increases that occurred before they reached age sixty-two. Thus, for example, recipients who reached age sixty-two in 1983 would have the benefit increases that became generally effective in the 1979–1982 period factored into their current benefit levels. Earnings they may have had in 1983 or later would still be excluded, as under the current rules.

A related but less expensive measure would be to factor only a portion of the benefit increases before age sixty-two into the benefits. One such approach would be to factor in only the portion that exceeded the future inflation assumptions made for the 1979–1982 period when the 1977 amendments were enacted—the rationale being that the benefit disparities causing the notch are in part the result of giving greater than anticipated benefit increases to people who were unaffected by the new rules. Another would be simply to devise ad hoc increases to supplement the benefits computed under the transitional guarantee so that the average benefits of each successive group of new retirees are no lower than those of the preceding group.

Freeze social security benefits for one year for certain recipients who reaped the largest windfalls from the old system. People who gained the most from being able to use the old benefit rules without limitation were those who reached aged sixty-two in 1977 and 1978. Under this proposal people who reached age sixty-two in these years would not receive a coming benefit increase that would otherwise be payable under the automatic cost-of-living adjustment provisions. This would lessen the differences in their current benefits from those of recipients who reached age sixty-two before and after them.

Refund a portion of the social security taxes of those who were unable to count their earnings after age sixty-one. Under this proposal people who had

to use the transitional guarantee and had earnings at age sixty-two or later but were unable to count them would receive a refund of part of their social security taxes. One such approach would simply allow a refund equal to the taxes paid in those years in which earnings could not be counted. Another would refund a percentage of the estimated taxes they paid over their working years reflecting the percentage difference in their monthly benefits caused by being unable to count earnings after age sixty-one.

4

Issues and Arguments

Arguments for Taking Legislative Action

Regardless of the worthy goals and financial necessity of the benefit computation changes enacted in 1977, people born after 1916 were required to use benefit rules that for many resulted in substantially lower benefits than they would have received if they had been born a few years earlier. Very sizable differences arose at all benefit levels. Table 2, for instance, shows the benefit differences that currently exist between workers reaching age sixty-two in December 1978 and in January 1979 who throughout their work histories earned low, moderate, or relatively high wages.

Moreover, the benefits provided to each successive group of new retirees reaching age sixty-two in the 1979–1985 period were frequently lower than those of similarly situated retirees who preceded them. In other words, notches occurred repeatedly throughout the phase-in period for the new system. Table 3 shows the current benefits being paid to retirees with various earnings histories who worked steadily throughout their working years and retired at age sixty-two or, alternatively, at age sixty-five at particular points during the 1978–1985 period. Although the downward trend for successive groups of workers who chose to retire immediately on reaching age sixty-two appears to have abated within the first few years of the phase-in period, generally the later a worker reached age sixty-two during the early years of the new system, the lower his or her benefits are likely to be today, particularly if he or she continued to work after reaching age sixty-two.

Exacerbating the complaints over these disparities is the fact that members of each successive recent group of newly eligible recipients are likely to have paid a greater amount of social security taxes over their lifetimes than the groups that preceded them. Both the social security tax rate and the maximum amount of earnings subject to the tax each year have risen very substantially over the past thirty years, as have the wages prevailing in the economy on which the social security tax is levied. Thus many people complaining about the notch perceive a dual injustice of

TABLE 2
CURRENT MONTHLY BENEFITS FOR WORKERS REACHING AGE 62
IN DECEMBER 1978 AND JANUARY 1979
(dollars)

	Worker Who Reached Age 62 in December 1978	*Worker Who Reached Age 62 in January 1979*
With history of low wages[a]		
Retired at age 63	371	354
Retired at age 65	460	408
With history of average wages[b]		
Retired at age 63	568	533
Retired at age 65	727	615
With history of high wages[c]		
Retired at age 63	721	677
Retired at age 65	908	781

a. A history of low wages is assumed to be one in which the worker always earned the federal minimum wage.
b. A history of average wages is assumed to be one in which the worker always earned amounts equal to those contained in the Social Security Administration's average wage series used for indexing various features of the social security program.
c. A history of high wages is assumed to be one in which the worker always earned amounts equal to the maximum earnings subject to the social security tax each year.
Source: Calculated from estimates contained in Actuarial Study no. 86, "Effects of the Various Social Security Benefit Computation Procedures," Office of the Actuary, Social Security Administration, July 1981. Estimates contained in table 8 of the study were indexed to reflect the benefit increases that would have occurred between the month of retirement and January 1985.

receiving lower benefits while having paid greater taxes to support the system.

In addition, the notch is not seen as affecting only a small, isolated group of recipients. It is viewed as a generalized loss of benefits that affects virtually every segment of the recipient population that became newly eligible after 1978. Of a little more than 10 million people who filed for benefits as retired workers from January 1979 to March 1985, more than 7 million still on the rolls in April 1985 were born after 1916 and had to use one or another of the new sets of benefit rules enacted in 1977.[26] Not all of them suffered losses, but the considerable publicity the notch problem has received has nurtured the perception that people born from 1917 to 1921 are generally not getting their fair share from the social security program.

It is likely that this has had a deleterious effect on public opinion about the program and the ability of Congress to manage it effectively. Lack of

TABLE 3

MONTHLY BENEFITS IN 1985 OF WORKERS RETIRING IN 1978–1985
(dollars)

Year in Which Benefits Began	*Work History*		
	Low wages[a]	Average wages[a]	High wages[a]
	Worker who retired at age 62[b]		
1978	319	482	606
1979	326	492	624
1980	310	462	588
1981	295	439	552
1982	295	430	546
1983	295	441	563
1984	299	449	578
1985	302	455	591
	Worker who retired at age 65		
1978	412	627	787
1979	421	643	808
1980	433	659	836
1981	442	681	865
1982	408	615	781
1983	394	592	759
1984	373	561	728
1985	369	548	717

a. For a description of what is meant by low, average, and high wages see notes a, b, and c of table 2.
b. Benefits for workers retiring at age sixty-two have been reduced by 20 percent to reflect actuarial adjustments for early retirement.
SOURCE: Calculated from data in unpublished tables formulated by Orlo Nichols of the Office of the Actuary of the Social Security Administration, March 29, 1985.

faith in the future of social security is hardly a new finding in opinion surveys of younger people. Lack of confidence in the system among the elderly, however, would be a particularly disturbing phenomenon since they have already reached the point in their lives when receipt of benefits is a reality, not something that may or may not happen in some distant future. Such a finding recently emerged in a summary of surveys conducted by Yankelovich, Skelly, and White for the American Council of Life Insurance. It showed that since 1982 a rising proportion of people in the age groups fifty-five to sixty-four and sixty-five and older were not confi-

dent about the future of the social security system.[27]

The report showed that 57 percent of those polled in September 1984 in the fifty-five to sixty-four age group were not confident about the future of the system, up from 43 percent in 1981. Of those sixty-five and older, 51 percent reported a lack of confidence, up from 26 percent in 1981.

What accounts for these findings? No one factor jumps out. The social security system had repeatedly been plagued with financing problems from 1974 to 1983, with enormous press coverage emerging in the latest episode, which led up to the social security amendments of 1983. Those amendments were signed into law in April 1983 and were widely reported as resolving the system's financial woes for many years into the future. Even with the repeated reports of financial problems preceding those amendments, the Yankelovich surveys suggest that the confidence of these older age groups remained relatively stable during the period 1978–1982.[28] The decline seems to have started in 1982 and continued through the last survey taken, in September 1984. The actual implementation of the 1983 amendments, which delayed the July 1983 cost-of-living adjustment to January 1984, and the provision calling for partial income taxation of benefits beginning in 1984 might provide a partial explanation. Those were changes that recipients felt, not just read about. And certainly the elimination of the minimum benefit beginning with those who became eligible in January 1982, the phasing out of the student benefit, and the tightening up of the disability program were among other, earlier changes that similarly had an immediate effect on the recipient population and might provide a further explanation.

The notch cannot be ignored, however, as another possible contributing factor. The notch gained greater prominence in the media as the transition to the new system progressed. Veterans' organizations and other interest groups picked up the issue and discussed it regularly in newletters and other publications circulated to their members.[29] Numerous congressional hearings, many of which were held across the country, helped to keep the issue from fading as it became more evident that neither the House Ways and Means Committee nor the Senate Finance Committee was likely to take action on the issue.

Thus many people who have called for legislative action to remedy the notch see it as contributing to a disturbing decline in the nation's faith in the system, particularly among the age groups that rely on it heavily for their income. They see it as possibly building on a series of small erosions of the program's benefits that many elderly see as broken commitments.

Proponents of taking action on the issue point out that, even though the notch does not seem to be a long-term, perennial problem, those who feel they have been unfairly treated will probably be on the benefit rolls for many years into the future. Thus the mere passage of time will not cause it

to go away—at least not very quickly. They contend that legislative action is necessary to show that Congress is willing to respond to inequities when they arise and that even minimal changes in the benefit rules would greatly lessen the perceptions of unfairness and lack of interest and thereby reduce the pressure to make very costly reforms.

Proponents further argue that even if the problem is one of having paid too much to one or more of the groups of recipients who became eligible in 1978 and earlier, the benefit disparities nonetheless are hardly an acceptable policy outcome. Congress certainly did not intend to create the differences when enacting the 1977 changes in the benefit rules. Moreover, those who benefited from the old rules were not catapulted into some blissful state of economic security; they simply received a little more than Congress intended. And those notch recipients seeking a higher payment from the system that earlier groups received do not see themselves as looking for economic windfalls, just fair increments in their current benefits. Therefore, it is argued that inaction on the basis that the notch problem arises from having paid some recipients too much—especially when they too number in the millions—is a technical excuse that is hard to sell to many who feel that they received the short end of the stick.

Finally, proponents defend the higher program costs that would arise from various notch remedies, arguing that the financial changes enacted in 1983 and the favorable effect of the recent strong economic recovery have significantly altered the gloomy prognoses made repeatedly by the social security actuaries during the ten-year period preceding the 1983 amendments. They point to the projections contained in the past three reports from the social security trustees, which suggest that the system will generate enormous surpluses beginning in the latter part of this decade and continuing for thirty or more years (see table 4).

The restoration of the old benefit rules for all current and future recipients would create enormous costs, which could not be sustained without very large increases in the social security tax. Proponents of a longer and more generous transition to the new system, however, would argue that the notch problem could be remedied, even if the costs were relatively large, without altering the tax schedule currently in the law and without jeopardizing the reasonably good financial outlook for the social security trust funds.

Arguments for Maintaining the Status Quo

Those who oppose altering the benefit rules to address the notch problem argue that the notch is a misleading label and that people required to use the new rules or the transitional guarantee were not unjustly penalized. They contend that it is inaccurate to view the notch as having some sort of

TABLE 4

PROJECTED FINANCIAL OPERATIONS OF THE SOCIAL SECURITY PROGRAM, 1986–2000

Year	*Projected Income ($ billions)*	*Projected Outgo*	*Difference*	*Reserves as % of Annual Expenditures*
1986	216.4	204.5	11.9	25
1988	270.1	237.0	33.1	30
1990	328.3	273.1	55.2	54
1995	469.6	368.1	101.5	139
2000	665.1	473.2	192.9	254

SOURCE: Harry C. Ballantyne, chief actuary, "Long-Range Estimates of Social Security Trust Fund Operations in Dollars," Office of the Actuary, Social Security Administration, Actuarial Note no. 125, April 1985, p, 3. Figures in first three columns are those contained in the intermediate II-B forecast described in the actuarial study. The reserve percentages in the right-hand column were taken from the *1985 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, March 28, 1985, p. 70 (once again under the intermediate II-B projections). These figures are reserves at the beginning of the year as a percentage of expenditures during the year.

cliff effect, where those on the plateau above get higher benefits than those in the valley below. There is no contesting the fact that many people required to use the rules prescribed by the 1977 amendments are receiving lower benefits than similarly situated people who became eligible for benefits before 1979. The benefits of those who became eligible in the 1975–1978 period, however, are also much higher than those of people who became eligible in 1974 and earlier.

Table 5 shows the current benefit levels of successive groups of workers who retired over the period 1972 to 1985. It becomes readily apparent that a few groups of recipients who became eligible in the middle of that period benefited greatly from being able to use the old benefit rules.

The one-time windfall effect is similarly illustrated by the long-run pattern of replacement rates provided by the social security program. Although some variations occurred over the years, social security replacement rates remained fairly stable during the 1950s and 1960s. With the large benefit increases enacted in the late 1960s and early 1970s, they shot up and continued to rise throughout the 1970s because of the overindexing phenomenon. Table 6 shows that they reached a pinnacle with the group of retirees reaching age sixty-five in 1981, after which they declined. Current projections show them leveling out with new groups of retirees becoming eligible in the middle to late 1980s.

It can also be argued that all current and future recipients have benefited

TABLE 5
MONTHLY BENEFITS IN 1985 OF WORKERS RETIRING AT AGE SIXTY-FIVE, 1972–1985
(dollars)

Year in Which Benefits Began	*Work History*		
	Low wages[a]	Average wages[a]	High wages[a]
1972	369	531	599
1973	393	540	615
1974	393	552	634
1975	382	564	658
1976	391	584	702
1977	399	603	748
1978	412	627	787
1979	421	643	808
1980	433	659	836
1981	442	681	865
1982	408	615	781
1983	394	592	759
1984	373	561	728
1985	369	548	717

Note: For workers retiring in January of each year.
a. For a description of what is meant by low, average, and high wages see notes a, b, and c of table 2.
SOURCE: Derived from unpublished tables formulated by Orlo Nichols of the Office of the Actuary of the Social Security Administration, March 29, 1985.

and will continue to benefit from the overindexing created by the automatic benefit increase provisions enacted in 1972 and 1973. Beginning in 1975 the initial benefits of each new group of retirees generally rose at a much faster rate than average wages nationwide. When Congress corrected this problem, it developed the new benefit rules in such a way that the relative benefits of all future recipients would be higher than those paid to people who became eligible before 1975. In other words, it intentionally overlooked a portion of the inadvertent real growth in benefits that had occurred as a result of the overindexing problem.

Table 7 shows how much lower benefits would have been at the time of retirement for each group of newly eligible retirees with work histories of average wages if their initial benefits had only kept up with the rise in average wages nationwide. It illustrates that every new group of average-earnings retirees in the 1975–1985 period received an advantage as a result of the overindexing but that those who reached age sixty-five in the 1980–1983 period clearly received the greatest advantage. The age group

TABLE 6
SOCIAL SECURITY REPLACEMENT RATES, WORKERS RETIRING AT AGE SIXTY-FIVE, 1955–2000
(percent)

Year of Retirement	*Work History*		
	Low wages[a]	Average wages[a]	High wages[a]
1955	49.6	34.6	32.8
1960	45.0	33.3	29.8
1965	40.0	31.4	32.9
1970	42.7	34.3	29.2
1975	59.5	42.3	30.1
1977	57.2	44.8	33.5
1978	62.7	46.7	34.7
1979	60.4	48.1	36.1
1980	64.0	51.1	32.5
1981	68.5	54.4	33.4
1985	63.8	41.3	22.8
1990	65.2	41.8	24.3
2000	63.1	41.3	25.4

Note: Replacement rates are defined here as benefits in the first year of entitlement as a percentage of the worker's earnings in his final year of work before retirement.
a. For a description of what is meant by low, average, and high wages see notes a, b, and c of table 2.
SOURCE: Derived from unpublished tables formulated by Orlo Nichols of the Office of the Actuary of the Social Security Administration, March 29, 1985.

that benefited the most was the last one permitted to use the old benefit rules—those who retired at age sixty-five in 1981 (that is, those who reached age sixty-two in 1978).

Proponents of maintaining the status quo argue that restoring the old benefit rules for everyone is wholly impractical. The financing problem Congress was confronted with in 1977 because of overindexing was not a minor one. The 1977 changes in the benefit rules eliminated more than half of the deficit then appearing in the long-term actuarial projections. They accounted for an improvement of nearly 5 percent of taxable payroll in the average long-range deficit, which in today's dollars would be the equivalent of $80 billion per year.[20] Proponents of the status quo view the increases in the social security tax rate required by such increased costs as totally unpalatable to the nation's work force. Moreover, without a "hold harmless" provision for those who, in the first few years of the new system, received higher benefits by using the new benefit rules, many retirees

TABLE 7
INITIAL MONTHLY BENEFIT AWARDS AND ESTIMATED AWARDS IF AWARDS HAD RISEN AT THE SAME RATE AS WAGES, 1973–1985
(dollars)

January	*Benefit Awarded*[a]	*Benefit if New Awards Rose at Same Rate as Wages*[a]	*Amount of Overcompensation*
1973	233	—	—
1974	238	248	–10
1975	270	262	8
1976	302	282	20
1977	332	301	31
1978	366	319	47
1979	400	345	55
1980	450	375	75
1981	532	409	123
1982	535	450	85
1983	553	475	78
1984	542	498	44
1985	548	500	48

Note: For workers with average wages retiring at age sixty-five.
a. Monthly benefit amount at the time of first receipt.
SOURCE: Column 1 was derived from unpublished tables formulated by Orlo Nichols of the Office of the Actuary of the Social Security Administration, March 29, 1985.

would have their benefits cut by a restoration of the old rules—and such a provision would further increase costs, so that the aggregate expenditures of the program would be higher than they would be if the 1977 amendments had not been enacted.

Opponents of action contend that even more gradual transitional approaches, such as the bill introduced by Representative Roybal, would also carry unpalatable costs. With a price tag in its first six years (1985–1990) of over $80 billion, the bill would equal in cost nearly half the financial changes that arose from the difficult benefit and taxing compromises enacted in 1983 to restore the system to a reasonably secure financial condition.[81] Even though the system's reserves are projected to be greater than $180 billion by the end of 1990, over the next three or four years the reserve cushion is estimated to equal little more than three to five months' annual expenditures—not a wide margin of safety by any historical standards.[82] A major downturn in the economy, coupled with the additional costs of a longer and more costly transition to the new system, might

renew the financing problems that plagued the program before the 1983 amendments.

Moreover, it must be recognized that the large surpluses projected to occur over the next three or four decades would be expected, under current projections, to offset later shortfalls between social security's income and outgo (arising in the 2020s and later years) when the post–World War II baby-boom generation reaches its retirement years. Even without any further change in the system's long-term cost, an actuarial deficiency of 0.41 percent of taxable payroll (equal to about $6 billion per year in today's dollars) is projected to arise over the next seventy-five years.[33] The Roybal bill was estimated by the social security actuaries to add another 0.40 percent of payroll to that deficit.[34] Opponents of the measure, therefore, argue that justifying the higher expenditures that would arise from this and similar bills by pointing to the social security surpluses projected for the next few decades ignores the long-range deficit effects that Congress strove so hard to remove from the projections in 1983.

Even if one accepted the proposition that the social security program could absorb the added costs of a more gradual transition, opponents contend that the higher expenditures would increase the enormous federal budget deficits projected for the remainder of this decade. Social security's income might be expected to exceed its outgo, but those surplus receipts are already factored into current budget projections. Those projections anticipate borrowing by the government's general fund of the excess social security receipts, thereby lessening the amount the government must take out of the nation's private investment markets. Spending those surpluses (or a portion of them) instead would force the government to borrow more from the public to finance its other activities. Opponents conclude that there is no way to avoid the fact that increases in social security expenditures would further harm the government's overall fiscal condition.

Opponents also argue that, even setting aside the budget effects, Congress should consider reducing social security taxes, or at a minimum keeping the coming increases for 1986, 1988, and 1990 from occurring, before planning to spend the surplus receipts.[35] They point out that the social security tax load is now larger than the income tax burden required of many, if not most, of the nation's families; that it is a regressive tax; and that it has a negative effect on national employment.

Opponents further argue that talking of resolving the notch issue might be a purely academic exercise given the operational burden it would impose on the Social Security Administration. Depending on how the problem was to be dealt with, the benefits of 10 million or more recipients would have to be recomputed. That is about three times the number of benefit awards computed each year by the agency. The Social Security Administration has been under enormous strain in recent years to keep up

with its workload, a strain that has caused considerable speculation that an operational breakdown was possible if a major overhaul of its systems was not implemented soon. That overhaul is currently under way, and forcing the agency to shift gears to recompute millions of benefit payments—many of which would probably have to be done manually—could set the needed administrative reforms back for years.

Finally, opponents argue that if a lack of confidence exists among the public, it is in part the result of irresponsible distortions of the notch problem. They contend that if advocates put as much effort into setting the facts straight about how the benefit disparities came about as they do into promoting their remedies, the public would be less critical of the disparities and more secure about Congress's ability to oversee the program.

NOTES TO TEXT

1. Memorandum from Roy A. Ferguson, actuary, Office of the Actuary, Social Security Administration, "Estimated Short-Range Cost of a Proposal to Increase Benefits for Certain Workers Who Attain Age 62 after 1978—Information," May 3, 1985. The memorandum contained estimates of the annual cost of H.R. 1917 (introduced by Representative Edward Roybal) assuming enactment in 1985: through calendar year 1990 the cumulative cost of the bill would be $81.8 billion, with annual costs at that time running at approximately $20 billion.

2. Unpublished tables reflecting a breakdown of social security recipients for the month of April 1985 showed that of 22.1 million people entitled to retirement benefits on account of their own earnings records, more than 7 million had their benefits computed through one or another of the methods prescribed by the Social Security Amendments of 1977 for people reaching age sixty-two after 1978 (born after 1916). The Social Security Administration refers to these monthly tabulations as the 1-A tables supplement (hereafter cited as 1-A tables supplement).

3. U.S. Congress, House, Committee on Ways and Means, Subcommittee on Social Security, *Hearings on Employer Payment of Social Security Taxes; Benefit Formula Differential*, 96th Congress, 1st session, September 27, 1979, p. 3, statement of Representative J. J. Pickle (D-Tex.), then chairman of the Subcommittee on Social Security of the House Ways and Means Committee.

4. U.S. Congress, House, Select Committee on Aging, *Hearings on Reductions in Social Security Benefit Levels: The Notch*, 98th Congress, 2d session, October 31, 1984 (in Council Bluffs, Iowa), p. 50. See testimony of Darlene Frazeur of Griswold, Iowa. The record states that if she had been born in December 1916, she would have been entitled to $519 a month on her own work record, but because she was born in February 1917, she was entitled to only $359 a month on her own record. Mrs. Frazeur was also entitled to a spousal benefit on her husband's work record of $385 a month; this higher amount is what she would have received if she had filed for benefits then.

5. For an illustration of different levels of confidence in the future of the social security system by age groups, see "Social Security: Young and Old View the System's Prospects," *Public Opinion*, vol. 8, no. 2 (April/May 1985), pp. 21–24 (hereafter cited as *Public Opinion* [April/May 1985]).

6. For an illustration in the press of a characterization of the notch in the way described in the text, see "Dear Abby," *Washington Times*, September 5, 1983.

7. For an example of interest in the issue by veterans' groups, see testimony of Alvin Krank, representing the American Legion of California, U.S. Congress,

House, Select Committee on Aging, *Hearings on Reductions in Social Security Benefit Levels: The Notch*, 98th Congress, 2d session, August 28, 1984 (Los Angeles, California), pp. 36–39.

8. For an elaboration of the necessity of changing the benefit rules to avoid this outcome, see U.S. Congress, House, *Report of the Quadrennial Advisory Council on Social Security*, House Document No. 94–75, 94th Congress, 1st session, March 10, 1975, pp. 14–15, 103–9.

9. Although they frequently recommended different remedies, most groups who testified before the House Committee on Ways and Means and the Senate Committee on Finance acknowledged the need to correct the faulty benefit rules resulting from the automatic benefit increase provisions enacted in 1972 and 1973.

10. U.S. Congress, House, Committee on Ways and Means, *Social Security Financing Amendments of 1977, Report to Accompany H.R. 9346*, 95th Congress, 1st session, October 12, 1977, pp. 3, 10 (hereafter cited as House Report on H.R. 9346).

11. One of the most commonly recognized differences in the treatment of different age groups under social security is that a recipient's benefits are not based on his or her contributions to the system. Early generations of recipients paid low taxes for relatively short periods of their working lives, but on retirement they received full benefits. This resulted from the fact that social security has been largely financed as a "pay-as-you-go" system, with tax rates set in such a way that the revenues flowing in were generally used immediately to pay for current benefit and administrative expenditures. Little excess was collected, and the small reserves of the system mostly served a contingency purpose. This method of financing was the outcome of the 1939 amendments and subsequent amendments to the program enacted in the 1940s. The result has been that as the system matures, each successive group of new recipients (and their employers) pays greater lifetime taxes for their benefits than the group that preceded them.

12. House Report on H.R. 9346, p. 7; and U.S. Congress, Senate, Committee on Finance, *Social Security Amendments of 1977, Report to Accompany H.R. 5322*, 95th Congress, 1st session, November 1, 1977, pp. 2, 19 (hereafter cited as Senate Report on H.R. 5322). The provisions of H.R. 5322 were substituted for the provisions in the House-passed version of H.R. 9346 when the full Senate took up H.R. 9346.

13. U.S. Congress, House, *Social Security Amendments of 1977, Conference Report to Accompany H.R. 9346*, 95th Congress, 1st session, December 15, 1977, p. 67.

14. House Report on H.R. 9346, pp. 22–24; and Senate Report on H.R. 5322, p. 2.

15. House Report on H.R. 9346, p. 23. See also A. Haeworth Robertson, "Financial Status of Social Security Program after the Social Security Amendments of 1977," *Social Security Bulletin*, vol. 41, no. 3 (March 1978), p. 23.

16. House Report on H.R. 9346, p. 23.

17. For a discussion on the record of these considerations, see U.S. Congress, House, Committee on Ways and Means, Subcommittee on Social Security, *Hearings on Decoupling the Social Security Benefit Structure, H.R. 14430*, 94th Congress, 2d session, June 18, July 23 and 26, 1976, pp. 77–78. This bill, then under consideration by the committee, contained the Ford administration's proposed changes to address the overindexing problem. Although the changes enacted by Congress the following year were different in a number of respects, application of the transition rules by age group was retained.

18. For support of this thesis, see minority views contained in House Report on H.R. 9346, p. 300. The statement suggests that the minority members of the committee had the impression that the dollar amounts of benefits that would be paid to new recipients in the future would not be lower than present levels. In fact, they stated that the benefits of future retirees would be higher than present levels.

19. None of the background committee prints leading up to the markups of the 1977 amendments by the House Ways and Means and Senate Finance committees or the reports by these committees to their respective bodies on their recommendations showed year-by-year benefits and replacement rates expected to arise before, in, and after the transition period. These documents largely skipped the years 1980 through 1984, which constituted the transition period, in showing the projected future benefits and replacement rates under old and new law. Generally, such data were presented in five-year intervals, leaving little or no possibility for observation of a notch effect by the members of the committees or Congress.

20. Steven F. McKay, F.S.A., and Bruce D. Schobel, F.S.A., "Effects of the Various Social Security Benefit Computation Procedures," Actuarial Study no. 86, Office of the Actuary, Social Security Administration, July 1981, p. 13 (hereafter cited as Actuarial Study no. 86). This analysis showed that 73 percent of the men and 58 percent of the women who filed for retirement benefits in 1979 used the old method—that is, they had reached age sixty-two before January 1979. In effect, 27 percent of the men and 42 percent of the women had to use one of the five new sets of benefit rules enacted in 1977 because they were born after 1916. The two sets of rules that were used by the vast majority were the new indexing procedures and the transitional guarantee.

21. House Report on H.R. 9346. See table on p. 29 of the report, which shows that an estimated 43 percent of newly eligible retirees were expected to use the transitional guarantee in 1979 but only 8 percent in 1983.

22. Ibid. See discussion "Wage Indexing of Earnings," pp. 24–25.

23. Actuarial Study no. 86, p. 18.

24. In the eleven-year period 1975 through 1985—the period in which social security benefit increases have been tied directly to the rise in the cost of living—the largest benefit increases became payable during the three-year period 1979–1981. They were 9.9, 14.3, and 11.2 percent, respectively.

25. This description of these bills is largely based on the analysis of the language of H.R. 1917 by the Office of the Actuary of the Social Security Administration as

summarized in the May 3, 1985, memorandum of Roy A. Ferguson, cited in note 1.

26. U.S. Social Security Administration, *Social Security Bulletin*, vol. 48, no. 6, p. 55. This table of the bulletin shows that 10.3 million people became entitled to social security benefits as retired workers between January 1979 and March 1985. The 1-A tables supplement showed that approximately 7.2 million people on the rolls in April 1985 had used one or another of the five new sets of benefits rules enacted in 1977; 6.1 million of them had used either the transitional guarantee or the wage-indexing methods.

27. *Public Opinion* (April/May 1985), p. 22.

28. Ibid.

29. For example, the Veterans of Foreign Wars of the United States published an article in its August 1983 issue of *Action, Washington Reporter* about the notch, intended to answer questions about how it arose.

30. House Report on H.R. 9346, table 4, p. 57.

31. Memorandum from Roy A. Ferguson, May 3, 1985. The 1983 amendments were projected to improve the financial position of the social security trust funds by about $166 billion over the seven-year period 1983–1989. Roy Ferguson's memorandum shows projected costs for Representative Roybal's bill of about $82 billion for the six-year period 1985–1990.

32. Projected under the intermediate II-B forecast of the 1985 trustees' report.

33. Ibid.

34. Memorandum from Steve Goss, actuary, Office of the Actuary, Social Security Administration, "Preliminary Estimated Long-Range OASDI Financial Impact of H.R. 4093," November 6, 1983. These estimates were based on the 1983 trustee report intermediate II-B assumptions, which did not differ greatly from the 1985 ones.

35. The total social security tax rate, including the Medicare portion, is scheduled under current law to rise in three stages from 7.05 percent each on employee and employer today to 7.65 percent in 1990.

COMMUNICATIONS

AMERICAN BAR ASSOCIATION **Governmental Affairs Office**
1800 M Street, N.W.
Washington, DC 20036
(202) 331-2200

January 23, 1989

The Honorable Daniel P. Moynihan
Chairman
Subcommittee on Social Security &
Family Policy
Committee on Finance
United States Senate
205 Senate Dirksen Office Building
Washington, DC 20510-6200

Dear Mr. Chairman:

We understand that your Subcommittee will be holding a hearing on the Social Security "Notch" issue. I am writing to share with your Subcommittee the policy of the American Bar Association on the subject.

In 1988, our House of Delegates adopted the following resolution which thereby became the official policy of the Association:

> BE IT RESOLVED, that the American Bar Association supports efforts to correct inequities, if any, in the Social Security law that impact upon Social Security recipients born between the years 1917-1921.

We request that this letter be made part of the hearing record.

Sincerely,

Robert D. Evans

RDE:saw
6203A

Testimony From Mr. Edwin R. Miner - Hoosier Coordinator
The Committee to Correct Inequities in Social Security and Medicare, Inc.
Council Bluffs, Iowa

Report to: The Chairman, Subcommittee on Social Security
and Family Policy, U.S. Senate Finance Committee.
January 23, 1989

February 1989 COMMITTEE HEARING ON "THE SOCIAL SECURITY BENEFIT NOTCH" AND RELATED SUBJECTS.

1 INTRODUCTION

According to SSA Publication No. 05-10379 issued March 1988 and revised February 1989, the Social Security program continues to operate on a sound financial basis. Income is expected to exceed outgo by about $45 billion in 1989 as compared to $36 billion in 1988. Current estimates show that the program will be able to pay benefits into the next century. Their table shows that in the year 2000 the income will exceed outgo by $185 billion, as compared to $0.4 billion reported in 1988, and the amount in the Trust Fund Reserves is estimated at $1.4 trillion, as compared to $1.3 trillion reported in 1988. How much will the difference be in 1990 and the year 2000? Does anyone really know? Long-range 75-year estimates in the 1988 Annual Reports of the Boards of Trustees of the Federal OASDI, based on intermediate economic assumptions, indicated that the OASDI program will enjoy about three decades of positive annual balances, followed by a comparable period of continuing annual deficits - the results of a lower ratio of workers to beneficiaries in the distant future - until the fund is exhausted in about 2048. What do the Trustees know that the Commissioner of Social Security doesn't know? How accurate are any of these predictions based on intermediate economic assumptions? All we know for sure is what Senator Daniel Moynihan, D, N.Y. stated in 1988 -- "The picure, of course, was not always so reassuring. It was not seven years ago that the then newly appointed Director of the Office of Management and Budget in the newly elected administration was declaring with respect to the Trust funds that 'the most devastating bankruptcy in history' was months away. Now we find ourselves dealing with the prospect of reserve amounts never previously contemplated."

11 NATIONAL ACADEMY STUDY - AN EXCUSE FOR INACTION ON THE NOTCH PROBLEM

On January 23, 1989, the Senate Subcommittee on Social Security and Family Policy reviewed findings of the National Academy of Social Insurance dealing with "The Social Security Benefit Notch: A Study." Both the chairman of the National Academy itself, former Social Security Commissioner Robert M. Ball, and the chairman of the study panel, former Deputy Commissioner Robert J. Mayer, have long been on record as opposing any steps to ease the Notch injustice. How can this report be fair and independent? The Academy's report does not address the real problem but only ties to whitewash and coverup Congress' lack of action. It concludes that the notch situation was undesirable and unfortunate and ends up on a negative note that the notch was one problem that might be best left alone. How can something that is undesirable and unfortunate be swept under the rug instead of being submitted to positive action to correct the inequity? This game politicans are playing with Social Security is not only dishonest, but it hurts senior citizens and trades away baby-boomers' future retirement benefits. Our five million members and supporters know how the Notch came about. What we want to know is what you are going to do about it?

111 PROBLEMS ATTENDANT UPON SOCIAL SECURITY SURPLUSES

These "surplus" Social Security funds are not used only for Social Security purposes; but they are invested, by law, in interest-bearing government securities. In effect the funds are used to decrease how much the federal government would have to borrow from domestic or foreign investors. A recent study entitled "Retirement Income for an Aging Population" states, "the projected annual Social Security surpluses are so great that the federal external debt - assuming that general fund deficits cease from the mid-1990s on - probably could be brought completely within the Social Security Trust funds by 2010."

To the extent that happens, then the huge Social Security surpluses may actually compound the deficit tax problems of the next generation, while giving us a false sense of security, since the Social Security account will show huge reserves that in reality have already been spent to hide the size of the deficits in other programs.

In either case, the large and growing annual Social Security surpluses will shift the burden of paying today's government programs from the income tax and other revenue sources to the Social Security tax.

Someday, when Social Security needs to call in its loans to pay benefits to the Baby Boomers, income and other general revenue taxes will need to be raised. So, at the very least, we should ask ourselves whether it makes sense to use Social Security taxes to pay the general government's bill in this century and then to use the general government's revenues to pay Social Security's bills in the next century.

IV CURRENT-COST FUNDING RECOMMENDED FOR OASDI

In analyzing the long-term condition of Social Security, GAO in its recent report accepted the conventional wisdom that traditional current cost financing should be abandoned and surpluses accumulate to help pay the retirement benefits of the baby boom generation. Numerous policy analysts, however, are challenging this conventional wisdom, including former Social Security actuary Robert Myers. Myers, frequently cited in the GAO report, recently said that these increases were unnecessary (Robert J. Myers, "Social Security Roller Coaster," Washington Post, August 20, 1987). Testifying at a Senate hearing, he said that current-cost funding is generally preferred over advance funding. The present system, a variety of advance funding, suffers in his view from the temptation it offers for excessive government spending. Accordingly, he would prefer that financing be on a "close to current-cost basis," with income slightly exceeding outgo each year, the intention being to build up a fund that is about equal to one years' outgo, and no more than that.

This proposal is based on intermediate-cost assumption about future performance of the economy. Future Congresses could legislate changes, if necessary, or an automatic adjustment mechanism could be established in the law.

V WHAT SHOULD BE DONE TO PRESERVE THE SOCIAL SECURITY TRUST FUNDS

Remove Social Security Trust Fund operations completely from the Budget process including all calculations of the annual deficit reduction targets.

Restore benefit equity to the Social Security program by correcting the unintended rapid reduction in benefits for persons born after 1916. Notch reduction averages in the five year transition are more than double congressional intent. (1977 Social Security Amendments)

Maintain the solvency of the Social Security Trust Funds on a sound, pay-as-you-go basis by reducing the future payroll tax rates to the lowest possible level consistent with the maintenance of a healthy Trust Fund Reserve and the payment of full and fair benefits to current and future retirees.

Assure the administrative integrity of the Social Security Administration by restoring Social Security to its original status as an independent government agency governed by its own Board of Directors appointed by the President and confirmed by the Senate.

Workers pay Social Security taxes to earn a right of a Social Security benefit, and their Social Security contributions should be managed and used for the sole and exclusive purpose for which they were raised. If we have a deficit problem in the rest of government, than we should solve it and not hide behind Social Security surpluses.

STATEMENT OF
ANTHONY PURCELL

SUBMITTED TO THE
SENATE FINANCE
SUBCOMMITTEE ON SOCIAL SECURITY
AND FAMILY POLICY

REGARDING

THE SOCIAL SECURITY NOTCH

JANUARY 23, 1989

Mr. Chairman:

My name is Tony Purcell and I am president of the Notch Babies Organization of Pennsylvania -- an independent organization of about 60,000 Notch victims.

This is the eleventh time since 1984 that I have come to Washington to seek a solution to the Notch problem. On six occasions our organization obtained permission to demonstrate with thousands of other Notch victims here at the Capitol or across from the White House.

We are an independent grassroots group that is part of a national coalition representing millions of Notch victims in scores of Notch groups from all sections of the country, including your own states of New York, Texas, New Jersey and Pennsylvania. We are proud to be affiliated with the National Committee to Preserve Social Security and Medicare chaired by James Roosevelt, the largest senior organization to support an end to the Notch injustice.

All reports and documents aside, I can assure you the Notch is real. I receive endless letters from Notch victims, some from as far away as the State of Washington asking me to do something about this terrible injustice that has been inflicted upon them. I can't tell you how disheartening it is to hear their stories and be unable to make their problems go away. I only wish that I alone had the power to solve this problem. You, Mr. Chairman, and members of this Subcommittee, are in a unique situation to do just that by reporting a Notch reform bill out of your committee so that it can be voted on by your colleagues.

We waited a long time for the GAO report and we were disappointed with its outcome. So when we heard another report was being prepared by

the National Academy of Social Insurance whose leaders are known to be vocal Notch opponents, I can say we were not surprised with the conclusions in that report either. Again, as with the GAO report, no one ever contacted the Notch leaders and asked us to help supply information to determine the severity of the problem or the impact it has had on Notch victims.

To me, this Academy report is simply another way of trying to confuse the facts with more information about "replacement rate" and "average earner" figures. Mr. Chairman, I do not have to understand these terms to recognize that many of my peers receive 20 to 30 percent less than some of their former coworkers.

When will Congress come out from behind this cloak of reports and deal directly with this problem? The longer Congress delays, the harder the battle for individuals like Mrs. Margaret Farrar of Vancouver, Washington who in a letter to me wrote:

> "I am one of the so-called Notch Babies born in 1921. It is not fair, I receive $257.00 a month. In January I will get a small increase, but as you know Medicare will take care of that. It has every year.
>
> It is very hard to get by. I reduced my electric to $15 a month, it is very cold at times. As you can see, I come from a very cold climate."

As you can see, Mrs. Farrar really needs the extra money a Notch reform bill would give her -- no matter what the amount.

I receive letters and hear stories such as Mrs. Farrar's all the time. I brought some of those letters here today so that you can look at them and see for yourselves how pitiful some of their stories are. I hope you will forgive me if after reading some of these letters I get disgusted when I read press articles and hear statements about our "well-to-do" seniors. Are we greedy folks who do not want to do our share? I do not think so -- the letters I receive and my own experience tell me this simply is not true.

I am lucky, I have a fairly comfortable retirement pension, combined with my Social Security earnings, so I manage alright. But I have sank many of my own dollars into efforts to fight this injustice for those who are less fortunate than me and who rely on this money -- and there are many of them.

Mr. Chairman, I have seven children and nineteen grandchildren. I would not support any proposal that I felt would hurt their chances of receiving their Social Security benefits. If you feel you need more money to

pay for correcting the Notch, why not get it from those making more than $48,000 who do not pay Social Security taxes on their high earnings?

I believe with the surpluses piling up in the Social Security Trust Funds, you ought to be looking at cutting my children's tax rates -- not cutting benefits. Right now, I'm afraid to think about my children's and grandchildren's retirement. If my peers' and my own benefits can be so dramatically reduced and no one is to be held accountable, who's to say the same won't happen to them? Someone has to take responsibility for ensuring that American citizens -- both young and old -- can depend on our Social Security system.

I hope that you, Mr. Chairman, and members of your Subcommittee will provide the leadership necessary to ensure that *all* Americans can continue to rely on this great program.

Thank you for allowing me to testify before you here today. I welcome any questions or comments you may have.

STATEMENT BY GRAY PANTHERS

Gray Panthers, an advocacy organization of 80,000 members and supporters working for social change and economic justice for people of all ages, is concerned that the position of the seven million Americans affected by the Social Security "notch" be clearly stated.

Figures show drastically reduced benefits for those born in 1917 - 21, and somewhat reduced amounts for those born in 1922 - 28 (see attached table). The idea that "notch" people received higher benefits than those born later is incorrect; this group old not receive credit for income earned after the age of 61.

Average earners born during the "notch" years received benefits as low as $560 per month on retirement; no one from earlier or later years among average earners received less than $600. Among "notch" residents of Westchester County, New York, Social Security benefits in January 1988 ranged primarily from $300 to $600 per month with a few receiving higher amounts.

The General Accounting Office report to Congress in March 1988 had statistics showing that the "notch" corrections in reform bills could very easily be paid by Social Security Trust Fund reserves. (Table 6.2, p. 77.)

The National Academy of Social Insurance report of Nov. 14, 1988, recognized that "the notch situation is undesirable and unfortunate," but it concluded that, in order to increase benefits for those born in the "notch" years, payments would nave to be reduced for people born in previous years. We do not believe this is necessary.

None of the "notch" reform bills call for any benefit decreases. They merely provide a gradual decline in benefits by year of birth starting in 1917 instead of the steep drops currently in effect.

The Academy also expressed concern that people born in later years might complain if "notch" payments are increased. There is no indication of this happening, and we do not think it is likely since "notch" reform bills would merely bring reductions in line so that later payments would fall into a rational pattern.

We urge the Congress to take appropriate action and bring some common sense into the picture.

Att: Table of benefits according to the Social Security Administration.
Table 6.2 from page 77 of the General Accounting Office report, March 1988.

1/23/89

COMPARISON OF AVERAGE MONTHLY SOCIAL SECURITY BENEFIT AMOUNTS IN 1991 FOR AGE 65 RETIREES WITH CAREER AVERAGE EARNINGS

Year of Birth	Year of Retirement At Age 65	Current Law 1977 Amendments	H.R. 1917 100th Congress	H.R. 1721 Rep. Daub
1915	1980	$675	—	—
1916	1981	$697	—	—
1917	1982	$630	$679	$681
1918	1983	$606	$681	$654
1919	1984	$575	$683	$635
1920	1985	$561	$693	$618
1921	1986	$572	$685	$596
1922	1987	$582	$652	$582
1923	1988	$589	$640	$589
1924	1989	$604	$623	$604
1925	1990	$608	$608	$608
1926	1991	$608	$608	$608

Source: Social Security Administration

Prepared for Chairman Roybal by the Subcommittee on Retirement Income and Employment

Table 6.2:

Effect of Proposed Notch Legislation on the OASDI Trust Funds (1987-1995)

Figures (except trust fund ratio) in billions of dollars; based on SSA estimates and alternative II-B economic assumptions

Projected status of OASDI Trust Funds (no notch legislation)

Calendar year	Excluding interest	Interest income	Total	Outgo	Balance, end of year	Trust fund ratio (months)[a]
1986			$216.8	$201.5	$ 46.9	29
1987	$224.6	$ 5.2	229.8	209.7	67.0	31
1988	252.2	7.3	259.4	222.6	103.9	40
1989	269.1	10.3	279.5	238.1	145.2	53
1990	295.3	14.2	309.4	255.1	199.6	67
1991	315.6	18.6	334.2	273.2	260.5	83
1992	337.5	23.2	360.7	291.1	330.2	100
1993	359.7	28.0	387.6	309.5	408.4	117
1994	382.8	33.0	415.7	328.9	495.2	134
1995	407.0	38.4	445.4	349.4	591.2	152
1996	433.2	44.1	477.3	371.1	697.3	169

Projected status of OASDI Trust Funds (notch legislation)

	H.R. 1917				H.R. 121/1721			
	Cost	Outgo	Balance, end of year	Trust fund ratio (months)	Cost	Outgo	Balance, end of year	Trust fund ratio (months)[a]
1987	$15.5	$225.2	$ 51.6	29	$—	$209.7	$ 67.0	31
1988	5.6	228.3	81.3	32	2.2	224.9	101.5	39
1989	6.5	244.6	114.1	43	2.6	240.7	140.0	52
1990	7.3	262.4	158.5	53	2.7	257.8	191.2	64
1991	7.9	281.1	208.1	66	2.8	275.9	248.7	79
1992	8.3	299.4	265.1	79	2.8	293.8	314.7	95
1993	8.5	318.0	329.6	93	2.8	312.2	388.9	111
1994	8.7	337.6	401.7	107	2.8	331.6	471.6	127
1995	8.9	358.3	481.9	122	2.8	352.0	563.2	144
1996	9.0	380.1	571.2	137	2.8	373.7	664.7	161
Total cost, 1987-96	$86.4				$24.3			

[a]Assets at beginning of year as a percentage of outgo during year.

Source:
United States General Accounting Office, "Report to: the Chairman, Subcommittee on Social Security, Committee on Ways and Means, House of Representatives," "Social Security, The Notch Issue," March 1988, GAO/HRD-88-62, p. 77.